

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE LAJAS
AUDITORIA 2005-2006

30 DE JUNIO DE 2006

OFICINA DEL COMISIONADO
DE ASUNTOS MUNICIPALES

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COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF LAJAS

SINGLE AUDIT REPORTING PACKAGE

FOR THE YEAR ENDED JUNE 30, 2006

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS**



**BASIC FINANCIAL STATEMENT AND
SUPPLEMENTAL SCHEDULE**

With Independent Auditor's Report There on
JUNE 30, 2006

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS**

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MEMBER:

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INDEPENDENT AUDITOR'S REPORT

**To the Honorable Mayor and
Municipal Legislature Body
Municipality of Lajas
Lajas, Puerto Rico**

I have audited the financial statements of the governmental activities, each major funds, and the aggregate remaining fund information of the Municipality of Lajas as of and for the year ended June 30, 2006 which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audit provides a reasonable basis for my opinions.

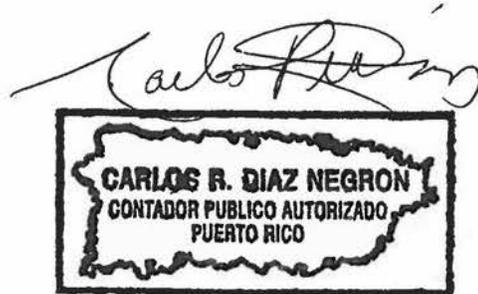
In my opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Lajas as of June 30, 2006, and the respective changes in financial position for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT (CONTINUED):

In accordance with Government Auditing Standards, I have also issued a report dated December 15, 2006, in my consideration of Municipality of Lajas's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts grants agreements and other matters. The purposes of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of my audit.

The management's discussion and analysis and budgetary comparison information on pages 3 through 13 and 55 through 56 are not required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. I have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, I did not audit the information and express no opinion on it.

My audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Lajas's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is not a required part of the basic financial statements of the Municipality of Lajas. The schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.



December 15, 2006
Aguas Buenas, Puerto Rico

License No. 1339
Expire December 1, 2007

The stamp No. 2204050 of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2006

Management of the Municipality of Lajas of the Commonwealth of Puerto Rico (the Municipality) provides this *Management's Discussion and Analysis* (MD&A) for the readers of the Municipality's basic financial statements. This narrative represents an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2006. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

Government-Wide Highlights

- ***Assets*** – The Municipality has reported assets amounting to \$23.2 million in the accompanying statement of net assets, of which the most significant are capital assets, cash and cash equivalents, and tax receivables amounting to \$11.2 millions, \$9.0 millions, and \$2.3 millions, respectively.
- ***Liabilities*** – The Municipality has reported liabilities amounting to \$12.6 million in the accompanying statement of net assets, of which the most significant are bonds and notes payable, unearned revenues, compensated absences, and accounts payable amounting to \$7.5 millions, \$0.6 millions, \$2.0 millions and \$0.9 millions respectively.
- ***Net assets*** – The assets of the Municipality exceeded its liabilities by \$10.6 millions at June 30, 2006, which is presented as “net assets” in the accompanying statement of net assets. Restricted net assets and unrestricted deficit amounted to \$3.3 millions and \$3.3 millions, respectively. Net assets invested in capital assets amounted to \$10.6 millions.
- ***Net change in net assets*** – The Municipality's net assets decreased by \$0.3 millions during fiscal year ended June 30, 2006. Net assets at June 30, 2006 amounted to \$10.6 millions. The decrease in net assets represents a negative result of operations and a diminish in the Municipality's overall financial position in comparison with the prior fiscal year.
- ***Revenues*** – The Municipality has reported total revenues amounting to \$11.8 millions in the accompanying statement of activities, of which the most significant are charges for services, intergovernmental grants and contributions, and taxes amounting to \$0.2 millions, \$7.2 millions and \$3.8 millions, respectively.
- ***Expenses*** – The Municipality has reported total expenses amounting to \$12.1 millions in the accompanying statement of activities.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2006

Governmental Funds' Highlights:

- ***Assets*** – The Municipality's governmental funds have reported combined assets amounting to \$12.3 millions in the accompanying balance sheet – governmental funds, of which the most significant are cash, due from other funds, taxes receivable and grants and contributions receivables amounting to \$9.0 millions, \$0.3 millions, \$2.3 millions and \$0.6 millions respectively.
- ***Liabilities*** – The Municipality's governmental funds have reported combined liabilities amounting to \$5.2 millions in the accompanying balance sheet – governmental funds, of which the most significant are deferred revenues, due to other funds and accounts payable and accrued liabilities amounting to \$3.2 millions, \$0.3 millions and \$0.9 millions respectively.
- ***Governmental fund balances*** – The Municipality's governmental funds reported combined fund balances amounting to \$7.0 millions, of which \$3.3 millions and \$(3.7) millions represent reserved and unreserved fund balances, respectively.
- ***Net change in governmental fund balances*** – The Municipality's governmental fund balances increased by \$0.5 millions during fiscal year ended June 30, 2006. Governmental fund balances at June 30, 2006 amounted to \$7.0 millions. The increase in net assets represents the excess of revenues and other financing sources over expenditures and other financing uses.
- ***Revenues*** – The Municipality's governmental funds have reported combined revenues amounting to \$11.5 millions in the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, of which the most significant are intergovernmental grants and contributions, property taxes and municipal license taxes amounting to \$6.9 millions, \$2.9 millions and \$0.6 millions, respectively.
- ***Expenditures*** – The Municipality's governmental funds have reported combined expenditures amounting to \$14.0 millions in the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, of which the most significant are categorized as capital outlays; general government; public housing and welfare; health and sanitation; urban and economic development and public safety amounting to \$1.7 millions, \$3.4 millions, \$2.6 millions, \$1.1 millions, \$3.3 millions and \$0.7 millions respectively.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements with focus is on both the Municipality as a whole (government-wide) and the major individual funds. Both perspectives (government-wide and major fund) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2006

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

The Municipality's financial statements include three components: (1) the government-wide financial statements, (2) the fund financial statements, and (3) the notes to the financial statements (collectively known as the basic financial statements). This report also contains additional required supplementary

information (budgetary schedules) and other supplementary information (combining financial statements) in addition to the basic financial statements themselves. These components are described below:

Government-Wide Financial Statements

The *government-wide financial statements* are designed to provide readers with a broad overview of the Municipality's operations and finance as a whole in a manner similar to private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at the end of the fiscal year. These financial statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means that these financial statements follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year ended June 30, 2006 even if cash involved have not been received or paid. The government-wide financial statements include: (1) the statements of net assets and (2) the statement of activities.

Statement of Net Assets

The statement of net *assets* presents all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity). Over time, increases or decreases in the net assets may serve as a useful indicator of whether the financial position of the Municipality is either improving or deteriorating.

Statement of Activities

The statement of activities presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2006. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as uncollected taxes and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

Both of the abovementioned financial statements present all the governmental activities of the Municipality, which consist mostly by taxes and intergovernmental revenues (such as federal grants). Most services provided by the Municipality fall into this category, including culture and education, general government, health and sanitation, public safety, public housing and welfare, etc.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2006

Fund Financial Statements

The Municipality's fund financial statements consist of: (1) the balance sheet – governmental funds and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position and results of operations of the Municipality's governmental funds.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal

requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial and contractual provisions.

The fund financial statements focus on: (1) individual parts of the Municipality's government and (2) reporting the Municipality's operations in more detail than the government-wide financial statements. For financial reporting purposes, the Municipality classifies its funds within the following fund categories: (1) general fund, (2) debt service fund, (3) special revenue funds and (4) capital projects funds (collectively known as the "governmental funds").

Governmental funds are used to account for all of the services provided by the Municipality. Governmental funds are used to account for essentially the same functions reported as governmental activities in the governmental-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources. They also focus on the balances of spendable resources available at the end of the fiscal year (June 30, 2006). This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the Municipality's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, that is, evaluating the Municipality's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the fund information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Municipality's near-term financial decisions.

For financial reporting purposes the Municipality has four major funds: (1) the general fund, (2) the state legislative joint resolutions, (3) the \$2,015,000 loan, and (4) the debt service fund.

Notes to the Basic Financial Statements

The notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and the fund financial statements. The notes to the basic financial statements can be found immediately following the basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2006

Required Supplementary Information

The basic financial statements are followed by a section of required supplementary information consisting of a budgetary comparison between actual operating results with the original budget and the final amended budget for the general fund.

INFRASTRUCTURE ASSETS

Historically, a government's largest group of assets (infrastructure – roads, bridges, traffic signals, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in governmental financial statements. GASB 34 requires that these assets be valued and reported within the governmental column of the Government-Wide Financial Statements. Additionally, the government must elect to either (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (modified approach) which periodically (at least every third year), by category, measures and demonstrates its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time.

As of July 1, 2003, the Municipality retroactively recorded the historical costs of infrastructure assets. Also the Municipality elected to depreciate infrastructure assets instead of using the modified approach.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. In the case of the Municipality, net assets (excess of assets over liabilities) amounted to \$10.6 millions at June 30, 2006, compared to \$10.9 millions at the end of the previous year.

The largest portion of the Municipality's net assets is invested in capital assets, net of their related debt (\$10.6 millions). The Municipality's net assets is also composed of net assets amounting to \$3.3 millions that are restricted for (1) future debt service payments, (2) the future acquisition or construction of capital assets and (3) other purposes, mainly the financing of federal and state assisted programs. In addition, the Municipality's net assets are reported net of an unrestricted deficit of \$3.3 millions.

The unrestricted deficit is the consequence of previous budgets which did not provide funding for incurred long-term obligations such as compensated absences and others. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation. Consequently, the Municipality cannot draw from its existing assets to provide services to its citizens and depends on its taxing ability to continue its operations.

The portion of the Municipality's net assets invested in capital assets such as land, buildings, equipment, etc., less any outstanding related debt used to acquire those assets., are used by the Municipality to provide services to its citizens; consequently these assets are not available for future spending. Although the Municipality's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from the debt service fund, since the capital assets themselves cannot be used to liquidate these liabilities.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2006

The following is a condensed presentation of the Municipality's financial position, as reported in the government-wide financial statements:

Condensed Statement of Net Assets
June 30, 2006 and 2005

	2006	2005
Assets:		
Current assets	\$ 11,911,587	\$ 11,089,692
Noncurrent assets:		
Capital assets, net	11,220,617	9,979,298
Other noncurrent assets	49,021	32,944
Total assets	<u>23,181,225</u>	<u>21,101,934</u>
Liabilities:		
Current liabilities	3,404,101	3,421,327
Noncurrent liabilities	9,157,624	6,753,968
Total liabilities	<u>12,561,725</u>	<u>10,175,295</u>
Net assets (deficit):		
Invested in capital assets, net of related debt	10,611,212	5,461,418
Restricted	3,338,968	6,527,055
Unrestricted	(3,330,680)	(1,061,837)
Total net assets	<u>\$ 10,619,500</u>	<u>\$ 10,926,636</u>

Changes in Net Assets

The Municipality's net assets decreased by \$0.3 millions. Approximately 32 percent of the Municipality's total revenues came from taxes, while 61 percent resulted from restricted and unrestricted capital and operating grants, contributions and reimbursements, including federal financial assistance. The Municipality's expenses cover a range of services. The largest expenses were for general government (29 percent), urban and economic development (28 percent) and public housing and welfare (23 percent).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2006

The following is a comparative condensed presentation of the Municipality's results of operations as reported in the GWFS:

Condensed Statement of Activities
June 30, 2006 and 2005

	2006	2005
Program revenues:		
Program-specific operating grants and contributions	\$ 2,258,258	\$ 1,682,779
Program-specific capital grants and contributions	503,445	2,350,881
Charges for services	215,572	224,037
Total program revenues	<u>2,977,275</u>	<u>4,257,697</u>
General revenues:		
Property taxes	2,891,221	2,915,900
Municipal license taxes	533,410	556,784
Construction excise taxes	398,679	242,080
Unrestricted grants and contributions	4,460,264	8,188,469
Unrestricted interest on deposits	86,619	31,923
Other general revenues (various sources)	455,013	452,693
Total general revenues	<u>8,825,206</u>	<u>12,387,849</u>
Total revenues	<u>11,802,481</u>	<u>16,645,546</u>
Program expenses:		
General government	3,513,820	5,075,024
Urban and economic development	3,330,332	2,001,820
Public safety	717,970	631,656
Health and sanitation	1,175,801	1,186,350
Culture, recreation and education	386,073	312,187
Public housing and welfare	2,779,598	2,955,455
Interest on long-term obligations	206,023	213,796
Total expenses	<u>12,109,617</u>	<u>12,376,288</u>
Net increase in assets	(307,136)	4,269,258
Net assets, at beginning of fiscal year	10,926,636	6,657,378
Net assets, at end of fiscal year	<u>\$ 10,619,500</u>	<u>\$ 10,926,636</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2006

FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds - The focus of the Municipality's *governmental funds* is to provide information on near-term inflows, outflows, and balance of *spendable resources*. Such information is useful in assessing the Municipality's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of fiscal year. The following is a condensed presentation of the Municipality's balance sheet and results of operations of governmental funds:

Condensed Balance Sheet-Governmental Funds
June 30, 2006 and 2005

	2006	2005
Assets:		
Total assets - major governmental funds	10,831,478	10,201,122
Total assets - other governmental funds	1,429,094	1,480,503
Combined total assets	12,260,572	11,681,625
Liabilities:		
Total liabilities - major governmental funds	4,435,123	4,270,094
Total liabilities - other governmental funds	785,694	884,476
Combined total liabilities	5,220,817	5,154,570
Fund balances:		
Reserved - major governmental funds	2,695,568	6,601,048
Reserved - other governmental funds	643,400	596,027
Unreserved - major governmental funds	3,700,787	(670,020)
Combined total funds balances	7,039,755	6,527,055
Total liabilities and fund balances:	12,260,572	11,681,625

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2006

**Condensed Statement of Revenues, Expenditures and Changes
in Fund Balances - Governmental Funds
June 30, 2006 and 2005**

	2006	2005
Revenues:		
Total revenues - major governmental funds	8,810,849	12,460,321
Total revenues - other governmental funds	2,718,416	4,120,078
Combined total revenues	<u>11,529,265</u>	<u>16,580,399</u>
Expenditures:		
Total expenditures - major governmental funds	10,374,969	11,006,980
Total expenditures - other governmental funds	3,664,596	4,044,604
Combined total expenditures	<u>14,039,565</u>	<u>15,051,584</u>
Excess of revenues over expenditures	<u>(2,510,300)</u>	<u>1,528,815</u>
Other financing sources (uses), net:		
Other financing sources (excluding operating transfers among funds)	3,023,000	665,000
Combined other financing sources (uses), net	<u>3,023,000</u>	<u>665,000</u>
Net change in fund balance	512,700	2,193,815
Fund balance, at beginning of fiscal year	<u>6,527,055</u>	<u>4,333,240</u>
Fund balance, at end of fiscal year	<u>7,039,755</u>	<u>6,527,055</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2006

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The accompanying statement of net assets reported total gross capital assets, at cost, amounting to \$46,918,924, of which \$30,364,488 represents infrastructure assets at June 30, 2006. The related accumulated depreciation and amortization of capital assets amounted to \$35,697,524, of which \$29,279,400 is related to infrastructure assets at June 30, 2006. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the municipal government, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

Actual costs incurred to purchase or construct capital assets were \$1,738,587 for the year ended June 30, 2006. Depreciation and amortization charges for the year totaled \$495,702.

The Municipality finances a significant portion of its construction activities through bond issuances and state and federal grants. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes.

Debt Administration

The laws and regulations of the Commonwealth of Puerto Rico have established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged.

The applicable laws and regulations also require that in order for a municipality to be able to issue additional general obligation bonds and notes, such municipality must have sufficient "payment capacity". Act No. 64 provides that a municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in such municipality's Redemption fund and the annual amounts collected with respect to such municipality's Special Additional Tax (as defined below), as projected by the Government Development Bank for Puerto Rico, will be sufficient to service to maturity the Municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

The Municipality is required under applicable laws and regulations to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax Levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2006

ECONOMIC FACTORS AND NEXT BUDGETS AND RATES

The Municipality relies primarily on property and municipal license taxes, as well as, federal and state grants to carry out the governmental activities. Historically, property and municipal license taxes have been very predictable with increases not generally exceeding ten percent. Federal grant revenues may vary if new grants are available but the revenue is also very predictable.

Those factors were considered when preparing the Municipality's budget for the 2005-2006 fiscal year. There were no significant changes between the budget for fiscal year 2006-2005 and the one for fiscal year 2005-2006.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayers, customers, investors and creditors) with a general overview of the Municipality's finances and demonstrate the Municipality's accountability. If you have any questions about the report or need additional financial information, contact the Municipality's Director of Finance, Mrs. Myrta L. Rodríguez Piñero, at PO Box 910, Lajas, Puerto Rico, 00667.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Statement of Net Assets
June 30, 2006

Assets	<u>Governmental activities</u>
Current assets:	
Account receivables:	
Taxes:	
Property taxes	\$ 2,182,054
Excise taxes	22,386
Municipal license taxes	46,970
Grants and contributions	625,757
Accrued interest on deposits	3,956
Restricted assets:	
Cash in commercial banks	4,937,471
Cash in fiscal agent	4,092,993
Total current assets	<u>11,911,587</u>
Noncurrent assets:	
Capital assets:	
Depreciable capital assets	41,598,681
Nondepreciable capital assets	5,320,243
Accumulated depreciation and amortization	(35,698,307)
Capital assets, net of accumulated depreciation	<u>11,220,617</u>
Deferred charges, net of accumulated amortization of \$28,737	49,021
Total noncurrent assets	<u>11,269,638</u>
Total assets	<u><u>\$ 23,181,225</u></u>

The accompanying notes to the basic financial statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Statement of Net Assets (continued)
June 30, 2006

Liabilities and net assets	Governmental activities
Current liabilities (due within one year):	
Accounts payable	\$ 929,475
Intergovernmental payables	165,125
Accrued employees christmas bonus	246,599
Accrued interest payable on long-term debt	41,083
Unearned revenues	616,547
Current portion of long-term obligations:	
Bonds payable	\$ 576,000
Notes payable	28,512
Obligations under capital leases	6,039
Compensated absences	794,721
Total current portion of long-term obligations	1,405,272
Total current liabilities	3,404,101
Noncurrent liabilities, excluding current portion (due in more than one year):	
Bonds payable	6,295,000
Notes payable	634,001
Landfill closure and postclosure costs	1,037,782
Obligations under capital leases	11,200
Compensated absences	1,179,641
Total noncurrent liabilities	9,157,624
Total liabilities	12,561,725
Net assets (deficit):	
Invested in capital assets, net of related debt	10,611,212
Restricted for:	
Debt service	\$ 393,257
Capital projects	372,281
Other specified purposes	2,573,430
Total restricted net assets	3,338,968
Unrestricted deficit	(3,330,680)
Total net assets	\$ 10,619,500

The accompanying notes to the basic financial statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Statement of Activities
Fiscal Year Ended June 30, 2006

Function/programs	Expenses	Program revenues		Net (expenses) and changes in net assets
		Charges for Services	Program-specific operating grants and contributions	
Governmental activities:				
General government	\$ 3,513,820	\$ 208,772		\$ (3,305,048)
Urban and economic development	3,330,332		\$ 435,384	\$ (2,610,065)
Public safety	717,970		114,900	27,207
Health and sanitation	1,175,801			(1,175,801)
Culture, recreation and education	386,073	6,800	7,394	57,688
Public housing and welfare	2,779,598		1,700,580	133,667
Interest on long-term obligations	206,023			(206,023)
Total governmental activities	<u>\$ 12,109,617</u>	<u>\$ 215,572</u>	<u>\$ 2,258,258</u>	<u>\$ 503,445</u>
General revenues				
Taxes:				
Property taxes				2,891,221
Municipal license taxes				533,410
Construction excise taxes				398,679
Total taxes				<u>3,823,310</u>
Grants and contributions, not restricted to specified programs				4,460,264
Unrestricted interest on deposits				86,619
Miscellaneous				455,013
Total general revenues and special item				<u>8,825,206</u>
Net change in net assets				(307,136)
Net assets at beginning of fiscal year				10,926,636
Net assets at end of year				<u>\$ 10,619,500</u>

The accompanying notes to the basic financial statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Balance Sheet – Governmental Funds
June 30, 2006

	<u>General fund</u>	<u>State legislative joint resolutions</u>	<u>\$ 2,015,000 Loan</u>	<u>Debt service fund</u>	<u>Other governmental funds</u>	<u>Total governmental funds</u>
Assets						
Account receivable, net of allowance of uncollectible accounts						
Taxes:						
Property taxes	\$ 1,517,656			\$ 664,398		\$ 2,182,054
Municipal license taxes	46,970					46,970
Excise taxes	22,386					22,386
Accrued interest on deposits				2,837	\$ 1,119	3,956
Grants and contributions	241,653				383,321	624,974
Due from other funds	238,042				111,726	349,768
Restricted assets:						-
Cash in commercial banks	184,044	\$ 4,644,786			108,641	4,937,471
Cash in fiscal agent	354,816		\$ 2,007,073	906,817	824,287	4,092,993
Total assets	<u>\$ 2,605,567</u>	<u>\$ 4,644,786</u>	<u>\$ 2,007,073</u>	<u>\$ 1,574,052</u>	<u>\$ 1,429,094</u>	<u>\$ 12,260,572</u>
Liabilities						
Accounts payable and accrued liabilities	\$ 501,814	\$ 225,028			\$ 202,633	\$ 929,475
Intergovernmental payable	165,125					165,125
Due to other funds	111,726			\$ 8,267	229,775	349,768
Advances to other funds						-
Deferred revenues	2,250,635			638,207	353,286	3,242,128
Matured bonds due and payable				534,321		534,321
Total liabilities	<u>3,029,300</u>	<u>225,028</u>	<u>-</u>	<u>1,180,795</u>	<u>785,694</u>	<u>5,220,817</u>
Fund balances						
Reserved for:						
Debt service				393,257		393,257
Capital project		295,238			77,043	372,281
Other specified purposes			2,007,073		566,357	2,573,430
Unreserved	(423,733)	4,124,520				3,700,787
Total fund balance	<u>(423,733)</u>	<u>4,419,758</u>	<u>2,007,073</u>	<u>393,257</u>	<u>643,400</u>	<u>7,039,755</u>
Total liabilities and fund balance	<u>\$ 2,605,567</u>	<u>\$ 4,644,786</u>	<u>\$ 2,007,073</u>	<u>\$ 1,574,052</u>	<u>\$ 1,429,094</u>	<u>\$ 12,260,572</u>

The accompanying notes to the basic financial statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Reconciliation of the Balance Sheet – Governmental Funds
to the Statement of Net Assets
June 30, 2006

The amounts of governmental activities reported in the statement of net assets and the balance sheet – governmental funds, are different for the following reasons:

Total fund balance reported in the balance sheet – governmental funds	\$ 7,039,755
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 dd (Deduct):

Capital assets used in governmental activities are not considered available financial resources at fiscal year-end, therefore, are not reported in the governmental funds.	11,221,400
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Deferred (unavailable) revenues in the governmental funds that are recorded as revenues in the statement of activities.	2,625,581
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Debt issued by the Municipality has associated costs (debt issued costs) that are paid from current available financial resources in the governmental funds. However, these costs are deferred in the statement of net assets and reported net of accumulated amortization.	49,021
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The following liabilities are not due (matured) in the current fiscal year, therefore are not reported in the governmental funds at June 30, 2005:

Bonds payable	(6,336,679)
Notes payable to CRIM	(662,513)
Obligation under capital leases	(17,239)
Compensated absences	(1,974,362)
Landfill closure and postclosure care costs	(1,037,782)
Accrued interest payable	(41,083)
Accrued employees' Christmas bonus	(246,599)

Net assets – governmental activities, as reported in the statement of net assets	\$ 10,619,500
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The accompanying notes to the basic financial statement are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Statement of Revenues, Expenditures and
Changes in Fund Balances – Governmental Funds
Fiscal Year Ended June 30, 2006

	General fund	State legislative joint resolutions	\$ 2,015,000 Loan	Debt service fund	Other governmental funds	Total governmental funds
Revenues						
Taxes:						
Property tax	\$ 2,354,632			\$ 576,137		\$ 2,930,769
Construction excise tax	398,679					398,679
Municipal license tax	575,390					575,390
Grants and contributions	4,043,109	\$ 133,667			\$ 2,690,447	6,867,223
Charges for services	208,772				6,800	215,572
Special items	-					-
Interest on deposits	26,403	2,776	\$ 9,756	26,889	20,795	86,619
Miscellaneous	454,639				374	455,013
Total revenues	<u>8,061,624</u>	<u>136,443</u>	<u>9,756</u>	<u>603,026</u>	<u>2,718,416</u>	<u>11,529,265</u>
Expenditures						
General government	2,435,101		7,927		946,025	3,389,053
Public safety	482,825				177,159	659,984
Health and sanitation	1,096,787					1,096,787
Public housing and welfare	476,873	425,207			1,707,274	2,609,354
Culture, recreation and education	334,972				15,697	350,669
Urban and economic development	2,894,948				435,384	3,330,332
Capital outlays	17,384	1,338,146			383,057	1,738,587
Debt service:						-
Principal	39,995			568,000		607,995
Interest	26,314			230,490		256,804
Total expenditures	<u>7,805,199</u>	<u>1,763,353</u>	<u>7,927</u>	<u>798,490</u>	<u>3,664,596</u>	<u>14,039,565</u>
Other financing sources (uses)						
Proceed from issuance of bonds	945,000		2,015,000		63,000	3,023,000
Transfer-In from other fund	50,538	61,230			1,005,676	1,117,444
Transfer-Out from other fund	(1,005,676)		(9,756)	(26,889)	(75,123)	(1,117,444)
Total other financial sources (uses)	<u>(10,138)</u>	<u>61,230</u>	<u>2,005,244</u>	<u>(26,889)</u>	<u>993,553</u>	<u>3,023,000</u>
Fund balance (deficit)						
at beginning of fiscal year	(670,020)	5,985,438	-	615,610	596,027	6,527,055
Net change in fund balance	246,287	(1,565,680)	2,007,073	(222,353)	47,373	512,700
Fund balance (deficit)						
at end of fiscal year	<u>\$ (423,733)</u>	<u>\$ 4,419,758</u>	<u>\$ 2,007,073</u>	<u>\$ 393,257</u>	<u>\$ 643,400</u>	<u>\$ 7,039,755</u>

The accompanying notes to the basic financial statements are an integral part of this statement.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Reconciliation of Statement of Revenues, Expenditures and Changes
in Fund Balances - Governmental Funds to the Statement of Activities
Fiscal Year ended June 30, 2006

The amounts of governmental activities reported in the statement of activities and the statement of revenues, expenditures and changes in fund balances are different for the following reasons:

Excess of revenues and other financing sources over expenditures and other uses reported in the statement of revenues, expenditures and changes in fund balances – governmental funds	\$512,700
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Add (Deduct):

Governmental funds report capital outlays as expenditures. However, in the accompanying statement of activities, the cost of those assets is allocated over their estimated useful life as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period	1,242,102
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Revenues from intergovernmental grants, property taxes and municipal license taxes in the statement of activities that do not provide current financial resources are not reported as revenue in the fund financial statements.	273,216
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Proceeds on issuance of bonds and bonds anticipation notes, are recorded as other financing sources in the fund financial statements, but the issuances increases long-term liabilities in the statement of net assets.	(3,023,000)
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Payments of obligations under capital leases are recorded as expenditures in the fund financial statements, but such payment reduces long-term liabilities in the statement of net assets.	5,576
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Repayment of bond and notes principal is recorded as expenditures in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets	602,419
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The landfill closure and post closures care costs do not require the use of current financial resources and therefore are not reported as expenditure in the fund financial statements.	(56,980)
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In the statement of activities, interest is accrued, whereas in governmental funds, interest expenditures is reported when due.	50,781
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Some expenses reported in the statement of activities do not require the use of current financial resources and are not reported as expenditures in governmental funds.	<u>86,050</u>
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Net change in net assets as reported in the accompanying statement of activities	<u>\$ (307,136)</u>
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The accompanying notes to the basic financial statement are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2006

1. Summary of Significant Accounting Policies

The Municipality of Lajas of the Commonwealth of Puerto Rico (the "Municipality") is a local government with full legislative, fiscal and administrative powers to operate as a government under Law No. 81 of August 30, 1991, as amended, known as the *Autonomous Municipalities Act of the Commonwealth of Puerto Rico (Law No. 81)*.

The Municipality's governmental system consists of executive and legislative branches. The Constitution of the Commonwealth of Puerto Rico (the "Commonwealth") provides for the separation of powers of the executive, legislative and judicial branches. A Mayor, elected every four years by the citizens, exercises the executive power of the Municipality. The legislative power is exercised by the Municipal Legislature, which is also elected every four years. The General Justice Court System of the Commonwealth, which has jurisdiction over the Municipality, exercises the judiciary power.

The Municipality assumes responsibility for providing services to its citizens related to public housing, welfare, public safety, health, sanitation, education, culture, recreation, urban and economic development, and many other general and administrative duties.

a) New Financial Reporting Model

The accompanying basic financial statements present the financial position and the results of operations of the Municipality as a whole, and its various governmental funds as of and for the year ended June 30, 2006, in conformity with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB).

In June 1999, GASB issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB No. 34). This statement established new financial reporting requirements for state and local governments. On July 1, 2003, the Municipality adopted the provisions of GASB No. 34 as well as other statements referred to below. These statements require the reporting of new financial information and restructured much of the information that governments have reported prior to July 1, 2003. Accordingly, comparability with financial statements issued for years ended June 30, 2003 or before, has been affected significantly.

According to the new financial reporting model established by GASB No. 34, the minimum required financial statement presentation applicable to the Municipality is composed of the following elements: (1) government-wide financial statements (GWFS), (2) governmental fund financial statements (GFFS), (3) notes to basic financial statements, and (4) required supplementary information (RSI).

The RSI, which consists of a management discussion and analysis (MD&A) and budgetary comparison schedule - General Fund that are information presented along with, but separate from, the Municipality's basic financial statements. The MD&A is a narrative report that introduces the accompanying basic financial statements and provides an analytical overview of the Municipality's financial activities for the year ended June 30, 2006, based on the Municipality's knowledge of the transactions, events and conditions reflected in the basic financial statements. The MD&A also highlights certain key fiscal policies that control the Municipality's operations.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2006

As previously mentioned, on July 1, 2003, other statements and interpretations were also adopted in conjunction and simultaneously with GASB No. 34. Those statements and interpretations are: (1) GASB Statement No. 33 – *Accounting and Financial Reporting for Nonexchange Transactions*, (2) GASB Statement No. 37 – *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments: Omnibus*, (3) GASB Statement No. 38 – *Certain Financial Statement Note Disclosures* and (4) GASB Interpretation No. 6 – *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

GASB No. 34 also required that the accounting for all governmental activities reported in the GWFS be based on applicable pronouncements issued by the Financial Accounting Standards Board (FASB) and its predecessor bodies, such as the Accounting Principles Board (APB), issued on or before November 30, 1989, provided those pronouncements do not conflict with or contradict GASB pronouncements. Accordingly, in conjunction and simultaneously with the adoption of GASB No. 34, the Municipality also adopted the following pronouncements: (1) APB Opinion No. 20 – *Accounting Changes*, (2) APB Opinion No. 21 – *Interest on Receivables and Payables*, (3) FASB Statement No. 5 – *Accounting for Contingencies* and (4) FASB Statement No. 16 – *Prior Period Adjustments*. The Municipality has elected to not apply all statements and interpretations issued by FASB after November 30, 1989.

b) *Financial Reporting Entity*

The accompanying basic financial statements include all departments, agencies and municipal entities that: (1) are under the legal and administrative control of the Mayor and (2) whose funds are under the legal custody and control of the Municipality’s Director of Finance and Budget, as prescribed by Law No. 81.

On July 1, 2006 the Municipality adopted the provisions of GASB Statement No. 40, *Deposit and Investment Risk Disclosures* – an amendment of GASB Statement No. 3. The new standard enhances the deposit and investment risk disclosures by updating the custodial credit risk disclosure requirements of GASB No. 3 and addressing other common risk, including concentrations of credit risk. The changes are reflected in Note 2.

c) *Government-wide Financial Statements*

The accompanying GWFS are composed of: (1) the statement of net assets and (2) the statement of activities. These financial statements do not report fund information but rather report information of all of the Municipality’s governmental activities. These statements are aimed at presenting a broad overview of the Municipality’s finances through reporting its financial position and results of operations as a whole, using methods that are similar to those used by most private businesses.

The focus of the GWFS is not on compliance with budgets, regulatory requirements or on the use of available or currently expendable financial resources (referred to as fiscal accountability), but on operational accountability information about the Municipality as a single economic unit. Operational accountability is the Municipality’s responsibility to report to the extent to which it has met its operating objectives efficiently and effectively, using all resources available for that purpose. It focuses on the Municipality’s principal operating objective, which is to provide services to its citizens.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2006

The accompanying statement of net assets provides short-term and long-term information about the Municipality's financial position and condition by presenting all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity). This statement assists management in assessing the level of services that can be provided by the Municipality in the future, and its ability to meet its obligations as they become due. In addition, this statement reports the extent to which the Municipality has invested in capital assets, including infrastructure, and discloses legal and contractual restrictions on resources.

Net assets are classified in the accompanying statement of net assets within the following three categories:

- **Invested in capital assets, net of related debt** – These consist of capital assets, net of accumulated depreciation and amortization, reduced by the outstanding balances of bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvement of capital assets have been reduced by any related unspent debt proceeds and any related unamortized debt issuance costs.
- **Restricted net assets** – These consist of net assets restricted by external parties (such as creditors, grantors, contributors, laws or regulations of other governments, etc.), or net assets for which constraints are imposed by constitutional provisions or enabling legislation. Enabling legislation is defined as legislation that authorizes the Municipality to assess, levy, charge or otherwise mandate payment of resources (from external resource providers). Enabling legislation establishes restrictions if it includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

The classification of restricted net assets identifies resources that have been received or earned by the Municipality with an explicit understanding between the Municipality and the resource providers that the resources would be used for specific purposes. Grants, contributions and donations are often given under those kinds of conditions. Bond indentures also often limit the use of bond proceeds to specific purposes.

Internally imposed designations of resources, including earmarking, are not reported as restricted net assets. These designations consist of management's plans for the use of resources, which are subject to change at the discretion of the Municipal Legislature.

- **Unrestricted net assets** – These consist of net assets that are neither externally or legally restricted, nor invested in capital assets. However, unrestricted net assets often are designated to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints that are imposed by management, but can be removed or modified.

When both restricted and unrestricted resources are available for use, it is the Municipality's policy to generally use restricted resources first, and then unrestricted resources as they are needed.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2006

The accompanying statement of activities presents the results of the Municipality's operations by showing how the Municipality's net assets changed during the year ended June 30, 2006, using a net (expense) revenue format. This statement presents the cost of each function/program as well as the extent to which each of the Municipality's functions, programs or other services either contributes to or draws from the Municipality's general revenues (such as property taxes, municipal license taxes, construction excise taxes, etc.).

A function/program describes a group of activities that are aimed at accomplishing a major service or regulatory responsibility. The functions/programs reported in the accompanying basic financial statements are: (1) general government, (2) urban and economic development, (3) public safety, (4) health and sanitation, (5) culture, recreation and education and (6) public housing and welfare. The governmental operations of the Municipality's departments and operational units are classified within the following functions/programs in the accompanying basic financial statements:

General government:

- Municipal legislature
- Mayor's office
- Department of finance and budget
- Department of human resources
- Department of municipal secretary
- Department of internal audit

Urban and economic development:

- Department of public works
- Department of tourism

Public safety:

- Department of municipal police
- Department of emergency management

Health and sanitation

- Department of health
- Department of sanitation

Culture, recreation and education:

- Department of recreation and sports

Public housing and welfare:

- Department of federal programs

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2006

The statement of activities demonstrates the degree to which program revenues offset direct expenses of a given function/program or segments. Direct expenses are those that are clearly identifiable with a specific function, segment or operational unit. This statement reports revenues in two broad categories: (1) program revenues and (2) general revenues.

Program revenues are generated directly from a program itself or may come from parties outside the Municipality's taxpayers or citizens. In the statement of activities, program revenues reduce the costs (expenses) of the function/program to arrive at the net cost of the function/program that must be financed from the Municipality's general revenues. The accompanying statement of activities separately reports the following categories of program revenues:

- **Charges for services** – These generally consist of exchange or exchange-like transactions involving charges to customers or applicants who purchase, use or directly benefit from the goods, services or privileges provided, or are otherwise directly affected by the services. These include fees charged for specific services, charges for licenses and permits, and fines and forfeitures, among others.
- **Program-specific capital and operating grants and contributions** – These consist of transactions that are either mandatory or voluntary nonexchange transactions with other governments, organizations, or individuals that restrict the resources for use in a particular program. Capital grants and contributions consist of capital assets or resources that are restricted for capital purposes – to purchase, construct or renovate capital assets associated with a specific program. Operating grants and contributions consist of resources that are required to be used to finance the costs of operating a specific program or can be used either for operating or capital purposes of a specific program. Restricted capital and operating grants and contributions are program revenues because they are specifically attributable to a program and reduce the net expense of that program to the Municipality. They are reported net of estimated uncollectible amounts.

General revenues are the default category for revenues. It includes all revenues and gains that do not meet the definition of program revenues. Property taxes, municipal license taxes and construction excise taxes are reported as general revenues. All other nontax revenues (including unrestricted investment earnings, grants and contributions not restricted for specific programs, and miscellaneous revenues) that do not meet the definition of program revenues are classified as general revenues. Resources that are dedicated internally by the Municipality are reported as general revenues rather than as program revenues. All general revenues are reported net of estimated uncollectible amounts, which are recorded as reduction of revenues rather than as expenses.

The *general government* function/program reported in the accompanying statement of activities, includes expenses that are, in essence, indirect or overhead expenses of the Municipality's other functions/programs. Even though some of these costs have been charged to other funds in the governmental fund financial statements as indirect cost allocations permitted under some federal programs, the Municipality has reported these indirect expenses as direct expenses of the general government function. Accordingly, the Municipality does not allocate general government (indirect) expenses to other functions.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2006

The effects of all interfund governmental activities (revenues, expenditures and other financing sources/uses among governmental funds) have been removed from the accompanying statements of net assets and activities.

The Municipality classifies all of its activities as governmental activities in the accompanying GWFS. These are activities generally financed through taxes, intergovernmental revenues and other nonexchange revenues that can be used to support the Municipality's programs or services. These governmental activities are also generally reported in the governmental fund financial statements.

The Municipality has no fiduciary activities, which are those in which the Municipality would be holding or managing net assets for specific individuals or other external parties in accordance with trust agreements or other custodial arrangements. In addition, the Municipality has no operations or activities that are primarily financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public is financed primarily through user charges.

d) *Governmental Fund Financial Statements*

The accompanying GFFS are composed of: (1) the balance sheet – governmental funds and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position and results operations of the Municipality's governmental funds by presenting sources, uses and balances of current financial resources. Some of these financial statements have a budgetary orientation and focus primarily on: (1) the Municipality's major funds, as defined below, (2) the fiscal accountability and (3) the individual parts of the Municipality's government. Fiscal accountability represents the Municipality's responsibility to justify that its actions in the current year have complied with public decisions concerning the raising and spending of public moneys in the short term (one fiscal year).

Each governmental fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity or deficit, revenue and expenditures. The accompanying GFFS segregate governmental funds according to their intended purpose and are used in demonstrating compliance with legal, financial and contractual provisions. The minimum number of governmental funds is maintained consistent with legal and self-imposed managerial requirements established by the Municipality. For financial reporting purposes, the Municipality classifies its governmental funds within the following categories:

- ***General fund*** – The general fund is the Municipality's main operating and major fund, as defined below, used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund. It is presumed that the Municipality's governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements or (3) the demands of sound financial administration requiring the use of a governmental fund other than the general fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2006

- **Special revenue funds** – The special revenue funds are nonmajor funds, as defined below, used by the Municipality to account for revenues derived from grants or other revenue sources (other than major capital projects) that are either self-restricted by the Municipality or legally restricted by outside parties for use in specific purposes. The uses and limitations of each special revenue fund are specified by municipal ordinances or federal and state statutes. However, resources restricted to expenditure for purposes normally financed from the general fund are reported in the Municipality's general fund provided that all applicable legal requirements are appropriately satisfied. In this case, a special revenue fund to account for such kind of transactions will be used only if legally mandated.

- **Debt service fund** – The debt service fund is a major fund, as defined below, used by the Municipality to account for the accumulation of resources for, and the payment of, principal and interest for: (1) bonds and notes for which debt service payments are legally mandated to be accounted for in a debt service fund and/or (2) general long-term debt for which the Municipality is being accumulating financial resources in advance, to pay principal and interest payments maturing in future years. Principal and accrued interest due on July 1 of the following fiscal year related to long-term debt for which debt service payments are accounted for in the debt service fund, are recorded as debt service fund's liabilities at June 30, if resources are available at June 30 for its payment.

General long-term debts for which debt service payments do not involve the advance accumulation of resources (such as obligations under capital leases, compensated absences, claims and judgments, and notes payable, among others) are accounted for in the accompanying statement of net assets. The debt service payments of such debts are generally accounted for in the general fund.

- **Capital projects funds** – Capital projects funds are major and nonmajor funds, as defined below, used to account for the financial resources used in the acquisition or construction of major capital facilities, other assets and permanent improvements. Significant capital outlays financed from general obligation bond proceeds are accounted for also in the capital projects funds.

The use of the capital projects funds has been reserved for major capital acquisitions or construction activities that would distort financial resources trend data if not reported separately from the other Municipality's operating activities. The routine purchases of minor capitalizable assets (such as certain vehicles and other minor capital assets) have been reported in the fund from which financial resources were used for the purchase.

Prior to GASB No. 34, the Municipality was required to report governmental fund financial statements that presented a single aggregated column for each fund type. Each column presented the combined total of all funds of a particular type. Fund types are no longer the focus of the accompanying governmental fund financial statements. Under GASB No. 34, the focus of the governmental fund financial statements is on major funds, which generally represent the Municipality's most important funds. Accordingly, the Municipality is required to segregate governmental funds among major and nonmajor within the governmental fund financial statements. Major individual governmental funds are reported individually as separate columns in the governmental fund financial statements, while data from all nonmajor governmental funds are aggregated into a single column, regardless of fund type.

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By definition, the Municipality's general fund is always considered a major governmental fund for financial reporting purposes. In addition, any other fund is considered a major fund for financial reporting purposes if its total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds. For the purposes of applying the aforementioned major fund criteria, no eliminations of interfund balances have been made. Total revenues for these purposes means all revenues, including operating and nonoperating revenues (net of allowances), except for other financing sources. Total expenditures for these purposes mean all expenditures, including operating and nonoperating expenditures, except for other financing uses.

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying governmental fund financial statements are: (1) the general fund, (2) the state legislative joint resolutions fund, (3) the \$2,015,000 loan fund and (3) the debt service fund.

The state legislative joint resolutions fund is a major fund used to account for financial resources derived from capital and operating grants awarded each year by the Commonwealth's Senate and House of Representatives (the Commonwealth's Legislature). The purpose of the amounts awarded by the Commonwealth's Legislature vary from year to year, but are generally restricted to (1) partially subsidy certain qualifying administrative and operational activities of the Municipality, (2) provide specific multipurpose services to citizens and (3) finance the acquisition or construction of capital assets approved by the Commonwealth's Legislature.

e) Measurement Focus and Basis of Accounting

Government-wide financial statements – The accompanying GWFS are prepared using the economic resources measurement focus and the accrual basis of accounting. Subject to the additional rules and limitations detailed below, revenues (including interest income) are generally recorded when earned and expenses are generally recorded when a liability is incurred, regardless of the timing of related cash flows.

All revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are generally recorded when the exchange takes place. In exchange transactions, each party to the transaction receives and gives up essentially equal values. An exchange-like transaction is one in which there is an identifiable exchange and the values exchanged, though related, may not be quite equal. Nevertheless, the exchange characteristics of the exchange-like transaction are strong enough to justify treating it as an exchange for accounting purposes (examples include fees for licenses and permits, charges for services, and miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received).

All revenues, expenses, gains, losses and assets resulting from nonexchange transactions are recorded using the criteria set forth by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (GASB No. 33), which the Municipality adopted on July 1, 2002. GASB No. 33 established accounting and reporting standards for nonexchange transactions involving cash and financial or capital resources (for example, most taxes, grants and private donations). In a nonexchange transaction, the Municipality gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange

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transaction, in which each party receives and gives up essentially equal values. According to GASB No. 33, the Municipality groups its nonexchange transactions into the following four classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed nonexchange revenues, (c) government mandated nonexchange transactions, and (d) voluntary nonexchange transactions.

In the case of derived tax revenue transactions (such as municipal license taxes), which result from assessments the Municipality places on exchange transactions, receivables and revenues are recorded when the underlying exchange has occurred (that generally is, when the taxpayers' net sales or revenues subject to tax take place).

In the case of imposed nonexchange revenue transactions (such as property taxes), which result from assessments made by the Municipality on nongovernmental entities, including individuals, other than assessments on exchange transactions, receivables are generally recorded in the period when an enforceable legal claim has arisen. Property taxes are generally recorded as revenues (net of amounts considered not collectible) in the period when resources are required to be used or the first period that the use of the resources is permitted.

Government-mandated nonexchange transactions (such as grants and contributions) result when a government at one level (such as the federal or state government) provides resources to another government (such as the Municipality), and the provider government requires the recipient government to use those resources for a specific purpose or purposes established in the provider's enabling legislation. In these types of transactions, receivables and revenues are generally recorded as follows:

- For reimbursement-type (commonly known as "expenditure-driven awards"), receivables and revenues are recorded when all eligibility requirements imposed by the provider have been met. The Municipality must expend resources on the specific purpose or project before the provider reimburses any amounts. Revenue is, therefore, generally recognized as qualifying reimbursable expenditures are incurred.
- For other types of grants (mainly grants and contributions with purpose restrictions but with no time requirements), receivables and revenues are recorded when all applicable eligibility requirements are met. When the provider is a government (including the government of the United States of America) the applicable recognition period for both, the provider and the recipient, is the provider's fiscal year and begins on the first day of that year.

Voluntary nonexchange transactions (such as donations and certain grants and entitlements) result from legislative or contractual agreements, other than exchanges, entered into willingly by two or more parties. In these types of transactions, receivables and revenues are generally accounted for in the same manner as government-mandated nonexchange transactions discussed above.

Receipts of any type of revenue sources collected in advance for use in the following period are recorded as deferred revenues.

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Events that are neither exchange nor nonexchange transactions are recorded when it is probable that a loss has been incurred and the amount of loss is reasonably estimable.

The measurement focus and the basis of accounting used in the accompanying GWFS differ significantly from the measurement focus and basis of accounting used in the preparation of the accompanying GFFS. Therefore, the accompanying GFFS include reconciliations to better identify the relationship between the GWFS and the GFFS.

Governmental fund financial statements – The accompanying GFFS are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are generally recognized as soon as they are both measurable and available. Revenues are generally considered to be available when they are collectible within the current year or soon enough thereafter to pay liabilities of the current year. For this purpose, the Municipality considers most revenues to be available if collected within 90 days after June 30, 2006, except for property taxes for which the availability period is 60 days. Revenue sources not meeting this availability criterion or collected in advance are recorded as deferred revenues at June 30, 2006. The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, intergovernmental grants and contributions and interest income. These principal revenue sources meet both measurability and availability criteria in the accompanying GFFS, except for amounts recorded as deferred revenues.

In a manner similar to the GWFS, but subject to and limited by the availability criteria discussed above, all revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are also generally recorded when the exchange takes place. Accordingly, fees for licenses and permits, charges for services and miscellaneous revenues are recorded as revenues when collected because they are generally not measurable until actually received.

All revenues, expenses, gains, losses and assets resulting from nonexchange transactions are recorded in a similar manner to the GWFS, using the previously discussed criteria set forth by GASB No. 33 for nonexchange transactions, but subject to and limited by the availability criteria discussed above. Accordingly, municipal license tax receivables and revenues are generally recorded when the underlying exchange has occurred. Property tax receivables are also generally recorded in the period when an enforceable legal claim has arisen while property tax revenues (net of amounts considered not collectible) are also generally recorded in the period when resources are required to be used or the first period that the use of the resources is permitted. Receivables and revenues from reimbursement-type grants, contributions, donations and entitlements are also generally recorded as qualifying reimbursable expenditures are incurred, while receivables and revenues from other types of grants are recorded when all eligibility requirements imposed by the provider have been met.

Interest income is recorded when earned only if collected within 90 days after year-end since these would be considered both measurable and available.

As previously discussed, on July 1, 2003, the Municipality adopted the provisions of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* (GASBI No. 6), which modifies the recognition criteria for certain expenditures and liabilities reported under the modified accrual basis of accounting and clarifies a number of situations in which the Municipality should distinguish between governmental fund liabilities and general long-term liabilities.

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Pursuant to the provisions of GASBI No. 6, expenditures and related liabilities are generally recorded in the accompanying governmental fund financial statements in the accounting period in which the liability is incurred, as under the accrual basis of accounting, but only to the extent that they are normally expected to be liquidated with expendable financial resources.

Modifications to the accrual basis of accounting include:

- Employees' accumulated vacation, sick leave and compensatory time (compensated absences) is recorded as expenditure when consumed. The amount of the unpaid compensated absences has been reported only in the accompanying statements of net assets.
- Principal and interest on bonds and notes payable are recorded when they mature (when payment is due), except for principal and interest due in July 1 of the following fiscal year, which are recorded when resources are available in the debt service fund (generally June 30).
- Obligations under capital leases, amounts subject to claims and judgments under litigation and other long-term obligations are recorded only when they mature (when payment is due).
- Accounts payable and accrued liabilities not expected to be liquidated with available and expendable financial resources are recorded in the accompanying statement of net assets but not in the governmental funds.
- Executory purchase orders and contracts are recorded as a reservation of fund balance in the GFFS.

Liabilities outside the bounds of these exceptions or modifications are reported as governmental fund liabilities when incurred (including salaries, professional services, supplies, utilities, etc.) since these liabilities normally are paid in a timely manner and in full from current financial resources.

The measurement focus of the GFFS is on decreases in net financial resources (expenditures) rather than expenses. Most expenditures are measurable and are recorded when the related governmental fund liability is incurred. Allocation of costs, such as depreciation and amortization, are recorded in the accompanying statement of activities, but are not recorded in the accompanying GFFS.

Under the new financial reporting model established by GASB No. 34, all general capital assets and the unmatured long-term liabilities (determined using the modified accrual basis of accounting) are no longer reported in account groups within the governmental fund balance sheet but are incorporated into the accompanying statement of net assets since July 1, 2003.

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f) Stewardship, Compliance and Accountability

Budgetary Control

According to the Autonomous Municipalities Act of the Commonwealth of Puerto Rico, the Mayor and its Administrative Cabinet prepare annual budgets each fiscal year for the

Municipality's general fund and debt service fund. Such legally adopted budgets are based on expected expenditures by program and estimated resources by source for both funds. The annual budgets are developed using elements of performance-based program budgeting and zero-based budgeting, and include estimates of revenues and other resources for the ensuing fiscal year under laws and regulations existing at the time the budget is prepared.

The Mayor must submit an annual budgetary resolution project (the Project) to the Commissioner of Municipal Affairs of Puerto Rico (the Commissioner) and the Municipal Legislature no later than each May 10 and May 15, respectively. The Commissioner preliminarily verifies that the Project complies with all the applicable laws and regulations and may provide comments and suggestions to the Mayor on or before each June 13.

The Municipal Legislature has 10 business days, up to June 13, to discuss and approve the Project with modifications. The Municipal Legislature may amend the budgets submitted by the Mayor but may not increase any items so far to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. After the Municipal Legislature modifies and preliminarily approves the Project, the modified Project is sent back to the Mayor for his approval or rejection within 6 days. The Mayor may decrease or eliminate any line item but may not increase or insert any new line item in the budgets. The Mayor may also veto the budgets in their entirety and return it to the Municipal Legislature with his objections. If the Mayor rejects the Project, the Municipal Legislature will have up to 8 days to adopt or reject the recommendations or objections of the Mayor. The approved Project is sent again to the Mayor, which then would have 3 days to sign and approve it.

If the budgets are not adopted prior to the end of the deadlines referred to above, the annual budgets for the preceding fiscal year, as approved by the Legislature and the Mayor, are automatically renewed for the ensuing fiscal year until the Municipal Legislature and the Mayor approve new budgets. This permits the Municipality to continue making payments for its operations and other purposes until the new budgets are approved.

The annual budgets may be updated for any estimate revisions as well as year-end encumbrances and may include any additional information requested by the Municipal Legislature. The Mayor may request subsequent amendments to the approved budgets, which are subject to the approval of the Municipal Legislature.

The Municipality's Department of Finance and Budget has the responsibility to ensure that budgetary spending control is maintained. For day-to-day management control, expenditures plus encumbrances may not exceed budgeted amounts at the expenditure-type level of each cost center (activity within a program within a fund). The Mayor may transfer unencumbered appropriations within programs within funds. The Municipal Legislature may transfer amounts among programs within and among funds.

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The legal level of budgetary control (i.e., the level at which expenditures may not legally exceed appropriation) is at the functions/program level (general government, urban and economic development, public safety, health and sanitation, culture, recreation and education, and public housing and welfare) within a fund.

Under the laws and regulations of the Commonwealth, the appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided.

Budgetary Accounting

The Municipality's annual budgets are prepared under the budgetary (statutory) basis of accounting, which is not in accordance with GAAP.

Under the budgetary basis of accounting, revenue is generally recognized when cash is received. Short-term and long-term borrowings may be used to finance budgetary excess of expenditures over revenues.

The Municipality uses encumbrance accounting to record the full amount of purchase orders, contracts and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control. Accordingly, expenditures are generally recorded when the related expenditure is incurred or encumbered. Available appropriations and encumbrances are established to lapse one year after the end of the fiscal year. Amounts required to settle claims and judgments against the Municipality, and certain other liabilities, are not recognized until they are encumbered or otherwise processed for payment. Unencumbered appropriations and encumbrances lapse at year-end. Other appropriations, mainly capital projects appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The accompanying budgetary comparison schedule provides information about the general fund's original budget, the amendments made to such budget, and the actual general fund's results of operations under the budgetary basis of accounting for the fiscal year ended June 30, 2006. Further details of the Municipality's budgetary control at the legal level may be obtained from the Budgetary Liquidation Report for the fiscal year ended June 30, 2006, which is prepared by the Municipality's Department of Finance and Budget. Copies of that report may be obtained by writing to the Municipality's Director of Finance and Budget.

Accounting principles applied for purposes of developing data on a budgetary basis differ significantly from those used to present the governmental fund financial statements in conformity with GAAP. Accordingly, the accompanying budgetary comparison schedule is accompanied by a reconciliation of the differences between the budgetary basis and GAAP actual amounts.

The Municipality does not legally adopt budgets for the state legislative joint resolutions capital fund. The financial resources received by these funds are not subject to budgeting by the Municipality since the resources received each year from the respective grantors varies from year to year, and the respective amounts are granted at their discretion.

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g) *Unrestricted and Restricted Deposits*

The Municipality's deposits are composed of cash on hand, demand deposits and cash equivalents in: (1) commercial banks, (2) the Government Development Bank for Puerto Rico (GDB), a governmental bank and a major component unit of the Commonwealth, who is statutorily designated as fiscal agent of the Municipality, and (3) the Municipal Revenue Collection Center (CRIM, by its Spanish acronyms), a governmental entity responsible for the imposition and collection of property taxes on behalf of all municipalities of Puerto Rico.

The Municipality follows the practice of pooling cash. The balance in the pooled cash account is available to meet current operating requirements. Under the laws and regulations of the Commonwealth, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the federal depository insurance generally provided by the Federal Deposits Insurance Corporation (FDIC). All securities pledged as collateral are held by agents designated by the Secretary of the Treasury of the Commonwealth, but not in the Municipality's name.

Restricted assets include cash and cash equivalents in commercial banks, GDB and CRIM. These cash balances are classified as restricted assets since its use is limited for the specified purposes discussed below, which are established by applicable agreements or required by law.

Restricted cash with fiscal agent in the general and debt service funds represent property tax collections which are retained and restricted for the payment of the Municipality's debt service, as established by law. Restricted cash in fiscal agent in other governmental funds consists of unspent proceeds of bonds and notes, and the balance of interest and noninterest bearing accounts which are restricted for: (1) the acquisition, construction or improvement of major capital assets and the operations of federal and state funded programs.

h) *Unrestricted and Restricted Accounts and Notes Receivable*

In the accompanying GWFS, receivables consist of all revenues earned but not collected at June 30, 2006. Major receivable balances for the governmental activities include municipal license taxes, property taxes and intergovernmental receivables.

Tax receivables in the general fund represent uncollected property taxes and municipal license taxes. Restricted tax receivables in the debt service fund consist of uncollected property taxes, which are restricted for the payment of the Municipality's debt service, as established by law.

Intergovernmental receivables are composed of: (1) amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federal and state funded programs (recorded in the general fund, special revenue funds and capital project funds), and (2) contributions in lieu of taxes from the Puerto Rico Electric Power Authority, recorded in the general fund.

These accounts receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience, historical trends, current economic conditions and the periodic aging of accounts receivable.

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Activities among funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e. the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." Advances between funds, as reported in the GFFS, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

i) Capital Assets

Capital assets used in governmental activities include land and land improvements, buildings, structures and building improvements, machinery and equipment, furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. These assets are capitalized and reported in the accompanying statement of net assets. Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets.

The Municipality defines capital assets as assets with an individual cost of \$500 or more at the date of acquisition or construction, and with useful lives extending beyond one year. All assets with individual costs under \$500 or with useful lives not exceeding one year, are charged directly to expense in the accompanying statement of activities. In the governmental funds, all capital assets are recorded as expenditures.

In the statement of net assets, all capital assets are recorded at cost or estimated historical cost if actual cost was unavailable, except for donated capital assets, which are recorded at their estimated fair value at the date of donation. Estimated historical costs based on deflated current costs were used to value a significant portion of the infrastructure and certain land, buildings, structures and building improvements constructed or acquired prior to June 30, 2002. The method to deflate the current costs using an approximate price index was used only in the case of certain items for which their historical cost documentation was not available. Actual historical costs were used to value the infrastructure, land, building, structures, building improvements, construction in progress, machinery and equipment and licensed vehicles constructed or acquired during or after the year ended June 30, 2003.

Major outlays for capital assets and improvements are capitalized in the statement of net assets as projects are constructed. The costs of normal maintenance and repairs that do not add value to the asset or materially extend capital asset lives are not capitalized.

Depreciation and amortization expense is recorded only in the government-wide statement of activities. However, there is no depreciation or amortization recorded for land and construction-in-progress. Depreciable capital assets are generally depreciated or amortized over their estimated useful lives under the straight – line method, except for machinery and equipment held under capital leases which is depreciated over the shorter of its estimated useful life or the lease term. The estimated useful lives of major capital asset categories are:

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	<u>Years</u>
Land improvements	20
Buildings, structures and building improvements	30 to 50
Infrastructure	20 to 50
Licensed vehicles	8
Furniture and fixtures	5 to 20
Machinery and equipment, excluding those held under capital leases	5 to 20

Depreciation and amortization expense on capital assets are recorded as direct expenses of the function/program specifically identified with the asset. Depreciation and amortization of infrastructure is not allocated to various functions/programs but reported as direct expenses of the urban and economic development function.

j) Deferred Revenues

The Municipality reports deferred revenue on its GFFS and GWFS. In the GFFS, deferred revenue arises when:

- Potential revenue does not meet both the “measurable” and “available” criteria for revenue recognition in the current period. As previously discussed, available is defined as due (or past due) at June 30, and collected within 90 days (60 days for property taxes) thereafter to pay obligations due at June 30, or;
- The Municipality receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, the liability for deferred revenue is removed and revenue is recognized.

Deferred revenues at the government-wide level arise only when the Municipality receives resources before it has a legal claim to them.

k) Compensated Absences

Compensated absences are accounted for under the provisions of Statement No. 16, *Accounting for Compensated Absences*, issued by GASB (GASB No. 16). Compensated absences include paid time off made available to employees in connection with vacation, sick leave and compensatory time. The liability for compensated absences recorded in the accompanying statement of net assets is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2006 and (2) is not contingent on a specific event (such as illness) that is outside the control of the Municipality and the employee. The liability for compensated absences includes salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer’s share of social security taxes and medicare taxes).

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The vacation policy of the Municipality is established by law and provides for the accumulation of regular vacations at a rate of 2.5 days per month (30 days per year) per employee. Employees accumulate regular sick leave at a rate of 1.5 days per month (18 days per year). Employees accumulate compensatory time at a rate of 1.5 times the overtime worked. All vacation and sick leave days accumulated by employees in excess of 30 days and 90 days, respectively, are paid to employees each year, if not consumed, as required by law. In the case of compensatory time, the excess of 240 hours is paid to employees each year, if not consumed.

Upon termination of employment, an employee receives compensation for all accumulated unpaid regular vacation leave at the current rate. In the case of regular sick leave, if the employee terminates his or her employment with the Municipality before reaching 10 years of services, such regular sick leave is not paid to the employee, if not consumed. Upon termination of employment, an employee does not receive compensation for compensatory time, if not consumed. After 10 years of services any regular sick leave balance is paid to the employee. Accumulated vacation time is fully vested to the employee at any time.

The liability for compensated absences is reported in the statement of net assets. A liability for compensated absences is reported in the GFFS only if they have matured, for example, as a result of employee resignations and retirements.

l) Long-term Debt

The long-term liabilities reported in the accompanying statements of net assets include the Municipality's bonds, notes, obligation under capital leases, compensated absences and legal claims and judgments.

All long-term debt to be repaid from governmental resources is reported as liabilities in the accompanying statement of net assets. Principal and interest payments on bonds due in July 1 of the following fiscal year, are recorded as fund liabilities in the GFFS when resources are available in the debt service fund (generally at June 30). In the GFFS, the face amount of debt issued is reported as other financing sources when issued.

In the GWFS debt issuance costs are reported as deferred charges and are amortized under the straight-line method over the life of the debt while in the GFFS such costs are recognized as expenditures during the current period.

On July 1, 2002, the Municipality adopted the provisions of APB Opinion No. 21, *Interest on Receivables and Payables* (APB No. 21), to account for certain non-interest bearing notes payable to: (1) CRIM, (2) Puerto Rico Land Authority and Puerto Rico Aqueduct and Sewer Authority, two discretely presented component units of the Commonwealth, and (3) Puerto Rico Treasury Department and Puerto Rico Department of Labor and Human Resources, two agencies (governmental units) of the primary government of the Commonwealth.

According to APB No. 21, the Municipality has recorded such notes at present value with an imputed interest rate that approximates the rate that would have been used, using the same terms and conditions, if it had been negotiated by an independent lender. In the accompanying statement of net assets, such notes payable are reported net of the applicable unamortized discount, which is the difference between the present value and the face amount of the notes. The notes discount is amortized over the life of the notes using the effective interest method.

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Amortization of the notes discount is recorded as part of interest expense in the statement of activities. In the GFFS, notes discount is recognized as other financing uses during the current period.

m) Leases

The Municipality classifies its lease agreements either as operating or capital leases. Capital lease agreements are non-cancelable and involve, substance over form, the transfer of substantially all benefits and risks inherent in the ownership of the leased property, while operating leases do not involve such transfer. Accordingly, a capital lease involves the recording of an asset and a related lease liability at the inception of the lease. According to GAAP, the Municipality classifies a lease agreement as a capital lease if at its inception the lease meets one or more of the following four criteria:

- By the end of the lease term, ownership of the leased property is transferred to the Municipality.
- The lease agreement contains a bargain purchase option.
- The lease term is substantially equal (75% or more) to the estimated useful life of the leased property.
- At the inception of the lease, the present value of the minimum lease payments, with certain adjustments, is 90% or more of the fair value of the leased property.

Although the Municipality is prevented legally from entering into obligations extending beyond the current year budget, most capital lease agreements entered by the Municipality contain fiscal funding clauses or a cancellation clause that makes the continuation of the agreements subject to future appropriations. Leases that meet at least one of the aforementioned four criteria and have fiscal funding or cancellation clauses have been recorded as capital leases in the accompanying GWFS, since the likelihood of invoking the provision is considered to be remote. The Municipality's lease agreements do not include contingent rental payments or escalation clauses.

In the GWFS, the obligation under capital leases is recorded at the lesser of the estimated fair value of the leased property or the present value of the minimum lease payments, excluding any portion representing executor costs and profit thereon to be paid by the lesser. A portion of each minimum lease payment is allocated to interest expense and the balance is applied to reduce the lease liability using the effective interest method.

In the GFFS, the net present value of the minimum lease payments at the inception of the capital lease is recorded simultaneously as (1) expenditure and (2) other financing source. Minimum lease payments are recorded as expenditures in the GFFS.

n) Accounting for Pension Costs

For the purpose of applying the requirements of GASB Statement No. 27, Accounting for Pensions by State and Local Government Employers (GASB No. 27), the Commonwealth of Puerto Rico is considered to be the sponsor of the Employees' Retirement System of the

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Government of Puerto Rico and Its Instrumentalities (ERS) and System 2000, the two retirement systems in which the employees of the Municipality participate. Accordingly, the Municipality is considered a participant and not a sponsor of these retirement systems since the majority of the participants in the aforementioned pension trust funds are part of the financial reporting entity of the Commonwealth. Accordingly, no portion of the net pension obligation (NPO) related to ERS has been allocated to the Municipality in the accompanying basic financial statements. The basic financial statements of the Commonwealth account for the total amount of the net pension obligation of ERS, including any amount that may be allocated to the Municipality.

According to GASB No. 27, the Municipality accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying basic financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions.

o) Risk Management

The Municipality carries commercial insurance covering casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department (the Treasury Department) on behalf of all municipalities of Puerto Rico. The Treasury Department pays the insurance premiums on behalf of the Municipality and then is reimbursed each year through monthly equal payments deducted from the Municipality's gross property tax collections made by CRIM.

The Municipality carries insurance coverage for death and bodily injuries caused by automobile accidents. This insurance is obtained through the Automobile Accidents Compensation Administration ("ACAA", by its Spanish acronym), a discretely component unit of the Commonwealth. This insurance is compulsory for all licensed vehicles used on public roads and highways in Puerto Rico. The annual premium is \$35 per licensed motor vehicle, which is paid directly to ACAA.

The Municipality obtains workers' compensation insurance coverage through the State Insurance Fund Corporation ("FSE" by its Spanish acronym), a component unit of the Commonwealth. This insurance covers workers against injuries, disability or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment. Workers' compensation insurance premiums are also paid through monthly deductions made by CRIM from the Municipality's gross property tax collections.

The Municipality obtains unemployment compensation, non-occupational disability, and drivers' insurance coverage for its employees through various insurance programs administered by the Commonwealth's Department of Labor and Human Resources (DOL). These insurance programs cover workers against unemployment and provide supplementary insurance coverage for temporary disability, or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment. Unemployment compensation, non-occupational disability and drivers' insurance premiums are paid directly to DOL on a quarterly basis.

The Municipality also obtains medical insurance coverage for its employees. The current insurance policies have not been canceled or terminated at June 30, 2006. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

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p) Reservations of Fund Balances

Reservations of fund balances represent portions of fund balances that are legally segregated for specific future uses or are not appropriated for expenditure. The Municipality has the following types of reservations of fund balances:

- **Encumbrances** – Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts represent reservations of unexpired appropriations and generally will become liabilities in future periods as the goods or services are received.
- **Capital Projects** – Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
- **Debt Service** – Represent fund balances available to finance future debt service payments.
- **Advances**– Represent the reservation of resources set aside for long-term accounts, notes and interfund receivables, which are not considered current available financial resources.
- **Inventories and other current assets** – Represent the reservation of resources set aside for inventories and prepaid costs, which are not considered current available financial resources.
- **Other Specified Purposes** – Represent resources set aside for use in federal and state grant programs accounted for in the special revenue funds.

q) Interfund Activities

Permanent reallocations of resources among the Municipality's funds are classified as interfund transfers. The Municipality has the following types of activities recorded among funds in the accompanying GFFS:

- **Transfers** – Represent legally required transfers that are reported when incurred as “transfers-in” by the recipient fund and as “transfer-out” by the disbursing fund.
- **Intra-entity Activities** – Represent transfers among funds that are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.
- **Advances** – Represent amounts advanced among funds, which are not considered to be currently available financial resources.

In the GFFS, interfund activity has not been eliminated, as permitted by GAAP.

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r) Use of Estimates

The preparation of the accompanying basic financial statements in conformity with GAAP requires management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the basic financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

s) Future Adoption of Accounting Pronouncements

The GASB has issued the following standards that have effective dates after June 30, 2006.

- GASB Statement No. 44, *Economic Condition Reporting: The Statistical section – an amendment of NCGA Statement 1*, which is effective for statistical sections prepared for periods after June 15, 2005.
- GASB Statement No. 45, *Accounting and Financial Reporting by Employees for Post-employment Benefits Other than Pensions*, which is effective for fiscal years beginning after December 15, 2006.
- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation*, which is effective for fiscal years, beginning after June 15, 2005.
- GASB Statement No. 47, *Accounting for Termination Benefits*, which is effective for fiscal years, beginning after June 15, 2005.

The impact of these statements on the Municipality's basic financial statements has not been determined.

2. Deposits

The Municipality maintains its deposits in various commercial banks located in Puerto Rico and GDB. Proceeds from bonds and funds related to certain grant awards are required by law to be held with GDB.

The balances deposited in commercial banks are insured by the Federal Deposit Insurance Corporation (FDIC) generally up to a maximum of \$100,000 per depositor. Under the laws and regulations of the Commonwealth, public funds deposited in commercial banks must be fully collateralized for the amounts deposited in excess of the federal depository insurance. All securities pledged as collateral are held, in the Municipality's name, by the agents of the Commonwealth's Secretary of Treasury. Deposits with GDB are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2006.

On July 1, 2006, the Municipality adopted the provisions of GASB Statement No. 40 (GASB No. 40), Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3. This statement requires that state and local governments disclose essential risk information about deposits and investments. The disclosure requirements cover four main areas: (1) credit risk, (2) interest rate risk, (3) custodial credit risk, (4) foreign exchange exposure.

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Credit risk – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Municipality has no credit risk policy, since there are no investments.

Interest rate risk – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by limiting the weighted average maturity of its investments portfolio (cash equivalents consisting of certificates of deposit) to less than three months.

Custodial credit risk – In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. The Municipality has no deposit policy for custodial credit risk.

Foreign exchange risk – The risk that changes in exchange rates will adversely affect the value of an investment or a deposit. The Municipality has no policy for foreign exchange risk, since there are no foreign exchange deposits or investments.

Cash and cash equivalents as of June 30, 2006, are classified in the accompanying financial statements as follows:

Statement of net assets:

Restricted cash and cash equivalents	\$ 9,030,464
Total cash and cash equivalents	<u>\$ 9,030,464</u>

Cash and cash equivalents as of June 30, 2006, consist of the following:

Cash in commercial banks	\$ 4,937,471
Cash in fiscal agent	4,092,993
Total cash and cash equivalents	<u>\$ 9,030,464</u>

Pursuant to the Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico, the Municipality may invest in obligations of the Commonwealth, obligations of the United States of America, certificates of deposit, commercial paper, bankers' acceptances, or in pools of obligations of the municipalities of Puerto Rico, which are managed by GDB.

3. Municipal License Taxes

The Municipality is authorized by Law No. 81 to impose and collect municipal license taxes on all trade or business activities operated by any natural or legal person within the territorial area of Lajas. This is a self-assessed tax generally based on the business volume measured by gross sales. The Municipality establishes the applicable tax rates. At June 30, 2005, the municipal tax rates imposed by the Municipality were 1.50% for financing institutions and 0.50% for other types of taxpayers. Any taxpayers that have been granted with partial tax exemptions under any of the incentive tax laws of the Commonwealth ultimately pay municipal license taxes at reduced tax rates, generally between 60% and 90% under standard rates.

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Each taxpayer must assess his/her corresponding municipal license tax by declaring his/her volume of business through a tax return to be filed every April 15 based on the actual volume of business generated in the preceding calendar year. Taxpayers with a sales volume of \$1 million or more must include audited financial statements with their tax returns. The tax can be paid by the taxpayer in two equal installments due on July 15 and January 15, subsequent to the filing of the declaration. The first installment of the tax covers the six-month period ended December 31, subsequent to the filing date of the declaration, while the second installment of the tax covers the six-month period ended June 30 of the subsequent calendar year. If a taxpayer elects to pay the tax in full on the filing date of the declaration (generally April 15), a 5% discount is granted automatically on the total tax amount due.

Any municipal license taxes collected in advance (that is, pertaining to a future period) are recorded as deferred revenues. Deferred municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to \$434,758 at June 30, 2006, which represents municipal licenses collected in advance for the taxable year 2006-2005.

4. Property Taxes

The Municipality is authorized by Law No. 81 to impose and collect personal and real property taxes. Under the laws and regulations of the Commonwealth, personal property taxes can be imposed to any natural or legal person that at January 1 of each year is engaged in trade or business and is the owner of personal property used in trade or business.

Personal property taxes are self-assessed by taxpayers every year generally using the book value of personal property assets owned by the taxpayer at January 1 (assessment date) and reporting such taxable value through a personal property tax return filed on May 15 subsequent to the assessment date. The total personal property tax rate in force at June 30, 2006 was 6.23% (of which taxpayers pay 6.03% and 0.20% is reimbursed by the Department of Treasury). Real property taxes are assessed by CRIM. The assessment on real property is made every January 1 and is based on estimated current values of the property deflated to 1957 market prices. The total real property tax rate in force at June 30, 2003 was 8.23% (of which 8.03% is paid by taxpayers and 0.20% is also reimbursed by the Department of Treasury).

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value (at 1957 market prices). For such exempt amounts, the Department of Treasury assumes payment of the basic tax (4% and 6% for personal and real property, respectively) to the Municipality, except for property assessed of less than \$3,500 (at 1957 market prices), for which no payment is made.

CRIM is responsible for the billing and collections of real and personal property taxes on behalf of the Municipality. Prior to the beginning of each fiscal year, CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, CRIM advances funds to the Municipality based on the initial estimated collections. CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than each December 31. If CRIM remits to the Municipality property tax advances, which are less than the property tax actually collected, an additional property tax receivable is recorded at June 30. However, if advances exceed the amount actually collected by CRIM, an intergovernmental payable is recorded at June 30.

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Law No. 81 provides for the levy of an annual special tax of 1.03% of the assessed value of all real and personal property not exonerated from taxation. Such special tax is levied and collected by CRIM. Collections of this special tax are remitted to the Commonwealth's debt service fund for payment of debt service on general obligations of the Commonwealth.

In addition, 1.40% of the total personal and real property taxes collected by CRIM is restricted for the Municipality's debt service requirements and is retained by GDB for such purposes.

The Additional Lottery System of the Commonwealth (the "Additional Lottery") is an operational unit reported as an enterprise fund of the Commonwealth, which currently operates several betting alternatives to the citizens of Puerto Rico. The Additional Lottery is required every year to distribute a portion of its excess of revenues over expenses as follows:

- i. Thirty five percent (35%) of its net earnings (defined as the excess of revenues over expenses less an amount earmarked for the Fund for Rent and Home Improvement Subsidy Program for the Low-Income Qualifying Elderly) is earmarked to the municipalities of the Commonwealth, of which a maximum of \$26 million, on an annual basis, is distributed to the Municipal Equalization Fund held by CRIM to cover operating expenses and permanent improvements of the municipalities.
- ii. An additional amount not exceeding \$16 million, on an annual basis, is distributed to the Municipal Equalization Fund, provided it is within the 35% corresponding to the municipalities of the Commonwealth. When the accumulated municipal appropriations from the municipalities' Puerto Rico Health Reform are covered up to June 30, 1997, these resources will be assigned to the Health Insurance Administration, a component unit of the Commonwealth.

Total property tax receivable, net of an allowance for uncollectible accounts of \$1,442,331, amounted to \$2,182,054 at June 30, 2006. The composition of property taxes receivable and the related deferred revenue is as follows at June 30, 2006:

	General fund	Debt service fund	Total
Gross property taxes receivable	\$ 2,520,822	\$ 1,103,563	\$ 3,624,385
Less:			
Allowance for uncollectible accounts	(1,003,166)	(439,165)	(1,442,331)
Net property taxes receivable	<u>\$ 1,517,656</u>	<u>\$ 664,398</u>	<u>\$ 2,182,054</u>
Deferred (unavailable) property tax revenues in GFFS	<u>\$ 1,457,829</u>	<u>\$ 638,207</u>	<u>\$ 2,096,036</u>

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5. Interfund Transactions

On July 1, 2001 the Municipality adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures*, issued by the Governmental Accounting Standards Board. This statement requires the disclosure of the flow of resources between funds and to assess the collectibility of interfund balances. Interfund balances at June 30, 2006 are as follows:

Transfer to:	Transfer from:				Total
	Major funds			Other governmental funds	
	General fund	2,015,000 loan	Debt service fund		
Major funds:					
General fund		9,756	26,889	13,893	50,538
Joint resolutions				61,230	61,230
Nonmajor governmental funds	1,005,676				1,005,676
Total	<u>1,005,676</u>	<u>9,756</u>	<u>26,889</u>	<u>75,123</u>	<u>1,117,444</u>

Due to:	Due from			Total
	Major funds		Other governmental funds	
	General fund	Debt service fund		
Major funds:				
General fund		8,267	229,775	238,042
Nonmajor governmental funds	111,726			111,726
Total	<u>111,726</u>	<u>8,267</u>	<u>229,775</u>	<u>349,768</u>

At June 30, 2006 all amounts due to among funds are considered collectible by the Municipality's management.

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6. Capital Assets

Capital assets activity for the year ended June 30, 2006, was as follows:

	<u>Balance at beginning of fiscal year</u>	<u>Additions</u>	<u>Reclassifications</u>	<u>Balance at end of year</u>
Governmental activities				
Cost basis:				
Capital assets, not being depreciated/amortized:				
Land	\$ 919,331	\$ 1,601	\$ -	\$ 920,932
Construction in progress	3,447,673	1,211,687	(260,049)	4,399,311
Total capital assets, not being depreciated/amortized:	<u>\$ 4,367,004</u>	<u>\$ 1,213,288</u>	<u>\$ (260,049)</u>	<u>\$ 5,320,243</u>
Capital assets, being depreciated/amortized				
Land improvements	\$ 2,763,930	\$ -	\$ -	\$ 2,763,930
Buildings, structures, and improvements	3,743,541	192,163	260,049	4,195,753
Infrastructure	30,092,124	272,364		30,364,488
Machinery and equipment	1,587,216	29,977		1,617,193
Licensed vehicles	2,626,522	30,795		2,657,317
Total capital assets, being depreciated/amortized:	<u>\$ 40,813,333</u>	<u>\$ 525,299</u>	<u>\$ 260,049</u>	<u>\$ 41,598,681</u>
Total cost basis of capital assets	<u>\$ 45,180,337</u>	<u>\$ 1,738,587</u>	<u>\$ -</u>	<u>\$ 46,918,924</u>
Less: accumulated depreciation and amortization:				
Land improvements	\$ 2,043,607	\$ 59,526	\$ -	\$ 2,103,133
Buildings, structures, and improvements	1,445,560	79,655		1,525,215
Infrastructure	29,218,700	61,482		29,280,182
Machinery and equipment	962,526	82,547		1,045,073
Licensed vehicles	1,531,429	213,275		1,744,704
Total accumulated depreciation and amortization	<u>\$ 35,201,822</u>	<u>\$ 496,485</u>	<u>\$ -</u>	<u>\$ 35,698,307</u>
Net capital assets	<u>\$ 9,978,515</u>	<u>\$ 1,242,102</u>	<u>\$ -</u>	<u>\$ 11,220,617</u>

Depreciation and amortization expenses for the fiscal year ended June 30, 2006 was charged to functions/programs as follow:

Governmental activities:	
General government	\$ 210,817
Public safety	57,986
Public housing and welfare	170,244
Culture, recreation, and education	35,404
Health and sanitation	22,034
Total depreciation and amortization expense	<u>\$ 496,485</u>

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7. Employees Retirement System

The Municipality's employees participate in the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (the "System"). The System is the administrator of a multi-employer cost-sharing (as related to the Municipality's reporting entity) defined pension plan established by the Commonwealth. The System was created under Act. No. 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. The System covers all regular employees of the Commonwealth and its instrumentalities, the Municipality and other municipalities of the Commonwealth.

The System is independent, thus assets may not be transferred to another system or used for any purpose other than to benefit each system's participants. The System issues publicly available financial reports that include its basic financial statements and required supplementary information for each of them, including required six-year trend information. Those reports may be obtained by writing to the administrator of the System.

The System provides for retirement, death and disability benefits. Death and disability retirement benefits are available to members for occupational and non-occupational death and disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after 10 years of plan participation.

Retirement benefits are determined by the application of stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a plan member is eligible, is limited to a minimum of \$200 per month and a maximum of 75 percent of the average compensation.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created the System, was enacted with the purpose of establishing a new pension system ("System 2000"). System 2000 became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999, had the option to either stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000, are the only required becoming members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as cash balance plan. Under this new plan, there is a pool of pension assets, which will be invested by the System, together with those of the current defined benefit plan. The Commonwealth nor the Municipality will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275 percent of the employees' salary up to a maximum of 10.00 percent) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity U.S. Treasury Note; (2) earn a rate equal to 75 percent of the return of the System 2000's investment portfolio (net of management fees); or (3) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The employer's contributions (9.275 percent of the employees' salary which is applicable to the Municipality) will be used to fund the current plan.

System 2000 reduced the retirement age from 65 years to 60 for those employees who joined the current plan on or later January 1, 2000.

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Funding Policy:

Contribution requirements are established by law and are as follows:

Municipality	9.275% of gross salary
Employees:	
Hired on or before March 31, 1990	5.775% of gross salary up to \$6,600
	8.275% of gross salary over \$6,600
Hired on or after April 1, 1990	8.275% of gross salary

On August 12, 2000, Act No. 174 was approved to allow certain participants of the ERS to be eligible for early retirement upon attaining at least age 55 with 25 years of service, provided they made their election on or before April 1, 2001. Those who elected early retirement under this law will receive monthly benefits of 75 percent (if 25 or more year of service and 55, or 30 or more years or services and age 50) or benefits of 65 percent (if 25 years of service by less than age 55) of their average compensation which is computed based on the highest 36 months of compensation recognized by the System. In these cases, the employer (including the Municipality) is responsible for contributing to the System the amount needed to cover the benefit payments and employer contribution with respect to the participants covered until the participants reaches the normal retirement age.

Historically, the Commonwealth has reported the System as a single-employer plan (as relates only to the financial reporting entity of the Commonwealth) in its comprehensive annual financial report. Accordingly, any actuarial deficiency that may exist or arise related to the Municipality's participating employees will be assumed by the Commonwealth since the System does not allocate any actuarial deficiencies pertaining to municipal employees participating in the System. The Municipality is only required by law to make statutory contributions in the rates mentioned above. As a result, no net pension obligation nor net pension asset that may be allocable to the Municipality's participating employees, if any, has been recorded in the accompanying basic financial statements.

8. Long-Term Obligations

The Municipality's Legislature is legally authorized to determine the contracting of debts of the Municipality. Nevertheless, the laws and regulations of the Commonwealth also provide that:

- Direct obligations of the Municipality (evidenced principally by bonds and notes) are backed by the full faith, credit and taxing power of the Municipality; and
- Direct obligations are not to be issued if the amount of the principal of, and interest on, such bonds and notes (and on all such bonds and notes issued thereafter) which are payable in any fiscal year, together with any amount paid by the Municipality in the preceding fiscal year on account of bonds or notes guaranteed by the Municipality, exceed 10 percent of the total assessed value of the property located within the Municipality plus the balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service.

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In addition, before any new bonds or notes are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. At June 30, 2006, the Municipality is in compliance with the debt limitation requirements. The general long-term debt activity for the year ended June 30, 2006 was as follows:

	Balance at June 30, 2005	Borrowings or additions	Payments or deductions	Balance at end of fiscal year	Balance due within one year
Bonds payable	\$ 4,361,000	\$ 3,023,000	\$ (513,000)	\$ 6,871,000	\$ 576,000
CRIM:					
Act No. 42 - Financing agreement of the excess property tax advances over collections through fiscal year 2000	333,468		(4,861)	328,607	5,174
Other - LIMS	177,100		(23,650)	153,450	24,861
Delinquent property tax accounts	186,364		(5,908)	180,456	-
Landfill closures and postclosure costs	980,802	56,980		1,037,782	-
Compensated absences	1,955,385	18,977		1,974,362	794,721
Obligations under capital leases	22,815		(5,576)	17,239	6,039
Total	<u>\$ 8,016,934</u>	<u>\$ 3,098,957</u>	<u>\$ (552,995)</u>	<u>\$ 10,562,896</u>	<u>\$ 1,406,795</u>

a) Bonds Payable

The Municipality issues general and special (public improvements) obligations bonds and notes to provide for the acquisition and construction of major capital facilities and equipment, as well as, to cover certain operating needs.

For financial reporting purposes, the outstanding balances of bonds represent the total principal to be repaid. Bonds payable is composed as follows at June 30, 2006:

<u>Bonds payable:</u>	Outstanding balance
1996 serial bonds, original amount of \$415,000, due in annual principal installments ranging from \$10,000 to \$40,000; plus interest due in semiannual installments at variable rates not to exceed 6.58% through July, 1, 2013	\$ 260,000
2003 serial bonds, original amount of \$630,000, due in annual principal installments ranging from \$45,000 to \$85,000; plus interest due in semiannual installments at variable rates not to exceed 6.00% through July 1, 2014	585,000
2006 serial bonds, original amount of \$563,000, due in annual principal installments ranging from \$13,000 to \$37,000; plus interest due in semiannual installments at rate of 4.50% through July 1, 2029	537,000
1996 serial bonds, original issue amount of \$1,000,000, due in annual principal installments ranging from \$24,000 to \$66,000; plus interest due in semiannual installments at rate of 4.50% through July 1, 2021	741,000

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	Outstanding balance
2000 serial bonds, original amount of \$478,000, due in annual installments ranging from \$59,000 to \$78,000; plus interest due in semiannual installments at rate of 5.00% through July 1, 2007	78,000
2000 serial bonds, original amount of \$70,000, due in annual principal installments ranging from \$9,000 to \$12,000; plus interest due in semiannual installments at rate of 5.00% through July 1, 2007	12,000
2002 serial bonds, original amount of \$880,000, due in annual principal installments ranging from \$150,000 to \$205,000; plus interest due in semiannual installments at variable rates not to exceed 5.00% through July 1, 2006	205,000
2001 serial bonds, original amount of \$770,000, due in annual principal installments ranging from \$20,000 to \$75,000; plus interest due in semiannual installments at variable rates not to exceed 5.29% through July 1, 2020	685,000
2005 serial bonds, original amount of \$665,000, due in annual principal installments ranging from \$55,000 to \$75,000; plus interest due in semiannual installments at variable rates not to exceed 5.29% through July 1, 2015	610,000
1994 serial bonds, original amount of \$435,000, due in annual principal installments ranging from \$15,000 to 50,000; plus interest due in semiannual installments at variable rates not to exceed 7.61% through January, 1, 2008	135,000
2006 serial bonds, original amount of \$945,000, due in annual principal installments ranging from \$95,000 to 145,000; plus interest due in semiannual installments at variable rates not to exceed 5.29% through July 1, 2016	945,000
2006 serial bonds, original amount of \$2,015,000, due in annual principal installments ranging from \$30,000 to 155,000; plus interest due in semiannual installments at variable rates not to exceed 5.29% through July 1, 2031	2,015,000
1996 serial bonds, original amount of \$63,000, due in annual principal installments ranging from \$1,000 to 4,000; plus interest due in semiannual installments at variable rates not to exceed 7.61% through July 1, 2031	<u>\$ 63,000</u>
Total bonds payable	<u><u>\$ 6,871,000</u></u>

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These bonds are payable from the ad valorem property tax of 1.67% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

The laws and regulations of the Commonwealth provide that public debt of the Municipality will constitute a first claim on the available revenue of the Municipality. Public debt includes bonds and notes payable. The good faith, credit and taxing power of the Municipality are irrevocably pledged for the prompt payment of the principal and interest of the bonds and notes payable.

The Municipality levies an annual additional special tax of 1.40% of the assessed value of personal and real property. The proceeds of this additional special tax are deposited in a sinking fund established at GDB whereby sufficient funds must be set aside to redeem the bonds in minimum annual or biannual principal and interest payments. The proceeds of this special tax are recorded in the debt service fund.

Interest rates on serial bonds subject to variable rates are reviewed periodically by GDB and are based on the fluctuation of GDB's weighted average rate for its commercial paper program, not to exceed 8%. Under this program, GDB issues commercial papers in the U.S. taxable and tax-exempt markets, in the Eurodollar market and to corporations that have tax exemption under the Commonwealth's Industrial Incentives Act and qualify for benefits provided by the U.S. Internal Revenue Code Section 936.

Annual debt service requirements of maturity for bonds payable are as follows:

Fiscal year ending June 30,	Principal	Interest	Total
2007	\$ 576,000	\$ 338,806	\$ 914,806
2008	292,000	353,999	645,999
2009	420,000	329,407	749,407
2010	384,000	306,923	690,923
2011	413,000	283,539	696,539
2012-2016	2,182,000	1,055,642	3,237,842
2017-2021	1,131,000	619,198	1,749,998
2022-2026	659,000	358,187	1,017,587
2027-2031	814,000	132,128	945,728
Totals	<u>\$ 6,871,000</u>	<u>\$ 3,777,828</u>	<u>\$ 10,648,828</u>

b) Notes Payable to CRIM

Act No. 42 – Act No. 42 of January 26, 2000 was enacted to authorize CRIM to enter into a financing agreement of up to \$200 million, for a term not exceeding 30 years. The financing agreement allows for the financing of a debt that the municipalities of Puerto Rico have with CRIM, arising from the final settlements of property tax advances versus actual collections through fiscal year 2000. The amounts that the municipalities will collect from the additional property taxes resulting from the increases in the subsidy from the Commonwealth to the municipalities are assigned through this law to repay such loan. The increases in this subsidy were the result of the Public Law No. 238 of August 15, 1999.

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Fiscal Year Ended June 30, 2006

In addition, on December 16, 2002 the Municipality entered into a repayment agreement with GDB and CRIM to pay off the remaining \$346,906 of excess of property tax advances from fiscal year 2000 and 2001. CRIM retains the principal and interest from the property tax advances of the Municipality. The amounts retained by CRIM are remitted to GDB on July 1 of each year through July 1, 2032. The repayment agreement bears interest at variable rates determined by GDB (6.43% at June 30, 2005) but not exceeding 8.00%. The outstanding principal of the note payable to CRIM amounted \$333,468 at June 30, 2006. The principal and interest maturities are as follows:

Fiscal year ending June 30,	Principal	Interest	Total
2007	\$ 5,174	\$ 20,401	\$ 25,575
2008	5,507	20,068	25,575
2009	5,861	19,714	25,575
2010	6,238	19,337	25,575
2011	6,640	18,935	25,575
2012-2016	40,185	87,690	127,876
2017-2021	54,890	72,986	127,876
2022-2026	74,977	52,899	127,876
2027-2033	129,135	26,448	155,582
Totals	\$ 328,607	\$ 338,478	\$ 667,085

c) *Municipal Solid Waste Landfill Closure and Postclosure Care Costs*

According to the regulations set forth by the U.S. Environment Protection Agency (EPA) in its "Solid Waste Disposal Facility Criteria", issued on October 9, 1991, the Municipality is required to place a final cover on the Municipality's landfill site when it stops accepting waste, and to perform certain maintenance and monitoring functions at the site for 30 years after closure. In accordance with GASB No. 18, the Municipality has performed a study of the activities that need to be implemented at the Municipality's landfill to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. Based on this study, the Municipality has recognized a liability of \$1,037,782 in the accompanying GWFS using current costs allocated based on the actual landfill capacity used at June 30, 2006. The portion of the estimated current costs to be incurred in future years is approximately \$229,218, which has not been recorded yet in the accompanying GWFS. Actual costs may be different due to inflation, changes in technology, or changes in laws and regulations. At June 30, 2006, the Municipality's landfill is still operating and its remaining estimated useful life is approximately 6 years. Approximately 80 percent of the Municipality's total capacity has been used at June 30, 2006.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2006

d) Other – LIMS

On June 28, 2001, the Municipality entered into a financing agreement with CRIM for the payment of the Municipality's share of the cost of an information management system, acquired by CRIM on behalf of all municipalities, for the management of a digital database of taxpayers properties located in Puerto Rico. The face amount of the loan was \$319,692 and bears no interest. The note is payable in monthly installments of \$2,664 through December 1, 2011. This note has an imputed interest rate of 5.00% and was originally recorded at its present value of \$245,906, net of an unamortized discount of \$73,786, at inception. At June 30, 2006, the balance of this note amounted to \$153,450. The principal and discount amortization (recorded as interest expense) maturities are as follows.

Fiscal year ending June 30,	Principal	Interest	Total
2007	\$ 24,861	\$ 7,108	\$ 31,969
2008	26,133	5,836	31,969
2009	27,470	4,499	31,969
2010	28,876	3,093	31,969
2011-2012	46,110	1,847	47,957
Totals	\$ 153,450	\$ 22,383	\$ 175,833

e) Financing of delinquent property tax accounts sold

On April 22, 2002, the Municipality entered into a financing agreement with CRIM in the amount of \$186,364 for the payment of delinquent property tax account sold to private investors. The financing agreement in the form of a line of credit bearing interests at 6.50% during the first 5 years, and variable interests (125 points over LIBOR rate) during the next 25 years. At June 30, 2006, the outstanding principal balance amounted to \$180,456. The principal and interest maturities are as follows.

Fiscal year ending June 30,	Principal	Discount accretion	Total
2007	\$ -	\$ 12,114	\$ 12,114
2008	-	12,114	12,114
2009	3,384	12,014	15,398
2010	3,611	11,787	15,398
2011	3,853	11,545	15,398
2012-2016	23,498	53,493	76,991
2017-2021	32,493	44,498	76,991
2022-2026	44,933	32,059	76,991
2027-2032	68,684	15,231	83,916
Totals	\$ 180,456	\$204,855	\$ 385,311

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2006

f) Compensated Absences

At June 30, 2006, the liability for compensated absences is composed as follows:

	Due within one year	Due after one year	Total
Vacations	\$ 80,143	\$ 784,074	\$ 864,217
Sick leave	47,657	1,190,288	1,237,945
Compensatory time	666,921	-	666,921
Total:	\$ 794,721	\$ 1,974,362	\$ 2,769,083

9. Lease Obligations

The Municipality is obligated under capital leases with third parties that expire through 2009 for the acquisition of office equipment. The present value of the future minimum capital lease payments at June 30, 2006 reported in the accompanying government-wide statement of net assets is as follows:

Fiscal year ending June 30,	Amount
2007	6,039
2008	6,541
2009	4,659
Total future minimum lease payments	17,239
Less:	
Current portion of obligation under capital leases	6,039
Obligation under capital leases, excluding current portion	\$ 11,200

10. Commitments and Contingencies

The Municipality is defendant in various legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Act No. 104 of June 25, 1955, as amended, persons are authorized to sue the Municipality only for causes of actions set forth in said Act to a maximum amount of \$75,000 or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Act No. 9 of November 26, 1975, as amended, the Municipality may provide its officers and employees with legal representation, as well as assume the payment of any judgment that may be entered against them. There is no limitation on the payment of such judgment.

With respects to pending or threatened litigation, the Municipality has not reported liabilities for awarded or anticipated unfavorable judgments as of June 30, 2006. Management believes that any unfavorable outcome in relation to pending or threatened litigation would not be significantly.

Except for the litigation where the plaintiff alleged among other violate of civil rights and requests employment restitution. At present the employee was restored to his former position. In addition, the municipality has been required to pay salaries and bonuses retroactive to the date of his dismiss subject to certain adjustment. At present, the amount claim can't be reasonable estimated however, such amount will not exceed approximately \$240,000.

**OTHER SUPPLEMENTARY
INFORMATION**

*BUDGETARY COMPARISON SCHEDULE –
GENERAL FUND*

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Budgetary Comparison Schedule – General Fund
Fiscal Year Ended June 30, 2006

	Budgeted amounts		Actual amounts (budgetary basis) (see note 1)	Variance with final budget- over (under)
	Original	Final		
Revenues:				
Property taxes	\$ 2,374,196	\$ 2,374,196	\$ 2,273,115	(101,081)
Municipal license taxes	548,400	548,400	641,755	93,355
Construction excise taxes	700,000	700,000	398,679	(301,321)
Charges for services	207,000	207,000	198,123	(8,877)
Intergovernmental grants and contributions	4,655,261	4,655,261	4,142,466	(512,795)
Interest on deposits and investments	20,000	20,000	76,941	56,941
Miscellaneous	111,000	111,000	1,085,444	974,444
Total revenues	<u>8,615,857</u>	<u>8,615,857</u>	<u>8,816,523</u>	<u>200,666</u>
Expenditures:				
General government	3,174,840	2,100,195	2,151,893	51,698
Urban and economic development	2,563,538	2,557,111	2,853,517	296,406
Public safety	541,303	535,303	487,276	(48,027)
Public housing and welfare	474,393	474,696	462,272	(12,424)
Culture, education and recreation	655,587	653,087	628,919	(24,168)
Health and sanitation	1,206,196	1,206,196	1,127,995	(78,201)
Capital outlays		17,284	17,284	-
Debt service - principal		39,995	39,995	-
Debt service - interest	-	26,314	26,314	-
Transfers to others funds	-	1,005,676	1,005,676	-
Total expenditures	<u>\$ 8,615,857</u>	<u>8,615,857</u>	<u>8,801,141</u>	<u>\$ 185,284</u>
Net change in fund balance:			<u>15,382</u>	<u>15,382</u>
Explanation of Differences:				
Sources/inflows of financial resources:				
Actual amounts (budgetary basis) "available for appropriations from budgetary comparison schedule				\$ 8,816,523
Differences - budget basis to GAAP:				
Differences in assets and liabilities resulting from modified accrual basis of accounting in comparison with budgetary basis				(704,361)
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting.				(50,538)
Total revenues as reported on the statement of revenues, expenditures and changes in fund balances - general fund				<u>\$ 8,061,624</u>
Uses/outflows of financial resources:				
Actual amounts (budgetary basis) "total charges to appropriations" from budgetary comparison schedule				\$ 8,801,141
Differences - budget basis to GAAP:				
Transfers to other funds are outflows of budgetary resources				(1,005,676)
Differences in assets and liabilities resulting from modified accrual basis of accounting in comparison with budgetary basis				289,365
Prior year encumbrances recorded as current year expenditures for GAAP basis				1,174,365
Current year encumbrances recorded as expenditures for budgetary purposes				(1,453,996)
				<u>\$ 7,805,199</u>

The accompanying notes to the basic financial statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Notes to Budgetary Comparison Schedule – General Fund
Fiscal Year Ended June 30, 2006

The Municipality's annual budget is prepared under the budgetary basis of accounting, which is not in accordance with GAAP.

Under the budgetary basis of accounting, revenues are generally recognized when cash is received. Short-term and long-term borrowings may be used to finance budgetary excess of expenditures over revenues.

Under the budgetary basis of accounting the Municipality uses encumbrance accounting to record the full amount of purchase orders, contracts and other commitments of appropriated resources as deductions from the appropriation prior the actual expenditure. In the governmental funds, encumbrances accounting is a significant aspect of budgetary control. Accordingly, expenditures are generally recorded when the related expenditure is incurred or encumbered. Available appropriations and encumbrances are established to lapse one year after the end of fiscal year. Amounts required to settle claims and judgments against the Municipality, and certain other liabilities, are not recognized until they are encumbered or otherwise processed for payment. Unencumbered appropriations and encumbrances lap at year-end. Other appropriations, mainly capital projects appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The accompanying Budgetary Comparison Schedule – General Fund, provides information about the general fund's original budget, the amendments made to such budget, and the actual general fund's results of operations under the budgetary basis of accounting for the fiscal year ended June 30, 2006.

Except for the General Fund, the Municipality legally does not adopt budgets for its major special revenues and capital projects funds. Accordingly, the neither accompanying basic financial statements, nor required supplementary information include statements or revenues and expenditures – budget and actual-budgetary basis, or budgetary comparison schedules, respectively, for these major programs.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2006

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Schedule Of Expenditures Of Federal Awards
Year Ended June 30, 2006**

	<u>NUMBER</u>	<u>DISBURSEMENT</u>
<u>US Department of Housing and Urban Development</u>		
Passed through:		
Municipal Service Administration:		
Community Development Block Grant	14.228	\$ 913,782
Direct Program:		
Section 8- Housing Choice Vouchers	14.871	291,235
<u>US Department of Justice</u>		
Direct program:		
Public Safety Partnership and Community Policy Grants	16.710	7,914
Crime Victim Assistance Program	16.575	56,194
<u>US Department of Agriculture</u>		
Direct Program		
Water and Waste Disposal System for Rural Communities	10.760	1,022,925
<u>US Department of Health and Human Services</u>		
Passes through:		
PR Department of Family:		
Child Care and Development Block Grant	93.575	466,041
<u>US Department of Home and Security</u>		
Passes through:		
PR Office of Management and Budget (GAR)		
Public Assistance Grant	97.036	<u>82,732</u>
		\$2,840,823

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Notes To Schedule Of Expenditures Of Federal Awards
For The Year Ended June 30, 2006

1. BASIS OF PRESENTATION:

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Lajas and is presented on the cash basis of accounting. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, Audit of States, Local Governments and Non profit organizations. Therefore, some amounts presented in this Schedule may differ from amounts presented in, or used in the preparation of the financial statements.

**REPORT ON INTERNAL
CONTROL OVER FINANCIAL REPORTING
BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARDS**

Carlos R. Díaz Negrón

Certified Public Accountant

MEMBER:

American Institute of Certified Public Accountants
Puerto Rico Society of Certified Public Accountants

PO BOX 408, 44 RAFAEL LASA ST., AGUAS BUENAS, PR 00703 TEL. (787) 732-8020 FAX (787) 732-0685 - E MAIL: cardiaz@prtc.net

**REPORT ON INTERNAL
CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL
STATEMENT PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARD**

**To the Honorable Mayor and
Municipal Council
Municipality of Lajas
Lajas, Puerto Rico**

I have audited the financial statements of governmental activities, each major fund and the aggregate remaining fund information of the **Municipality of Lajas, Puerto Rico**, as of and for the year ended June 30, 2006 which collectively comprise the Municipality of Lajas's basic financial statements and have issued my report there on dated December 22, 2006. I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Municipality of Lajas's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL (CONTINUED):

Compliance

As part of obtaining reasonable assurance about whether the Municipality of Lajas's financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts and grants agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my test disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standard.

This report is intended solely for the information and use of the management and the Municipal Legislative Body of Municipality of Lajas, federal awarding agencies and passed through-entities and is not intended to be and should not be used by anyone other than these specified parties.

December 15, 2006
Aguas Buenas, Puerto Rico

License No. 1339
Expires December 1, 2007



The stamp No. 2204051 of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.

**REPORT ON COMPLIANCE WITH
REQUIREMENTS APPLICABLE
TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE IN ACCORDANCE WITH
OMB CIRCULAR A-133**

**REPORT ON COMPLIANCE WITH
REQUIREMENT APPLICABLE TO EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

**To the Honorable Mayor and
Municipal Council
Municipality of Lajas
Lajas, Puerto Rico**

Compliance

I have audited the compliance of the **Municipality of Lajas, Puerto Rico**, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2006. Municipality of Lajas, Puerto Rico's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of finding and questioned costs. Compliance with the requirement of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Municipality of Lajas, Puerto Rico's management. My responsibility is to express an opinion on the Municipality of Lajas, Puerto Rico's compliance based on my audit.

I conducted my audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of State and Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that I plan and perform the audit to obtain reasonable assurance about whether non-compliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Municipality of Lajas, Puerto Rico's compliance with those requirements and performing such other procedures as we considered necessary in the circumstance. I believe that my audit provides a reasonable basis for my opinion. My audit does not provide a legal determination on Municipality of Lajas, Puerto Rico's compliance with those requirements.

REPORT ON COMPLIANCE WITH REQUIREMENT APPLICABLE (CONTINUED):

As described in item 01-06, in the accompanying schedule of findings and questioned cost, the Municipality of Lajas did not comply with the requirements regarding special tests and provisions that are applicable to the Community Development Block Grant/State Program. Compliance with such requirements is necessary, in our opinion, for Municipality of Lajas to comply with requirements applicable to that program.

In my opinion, except for the non compliance described in the preceding paragraph, Municipality of Lajas, Puerto Rico, complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal program for the year ended June 30, 2006.

Internal Control Over Compliance

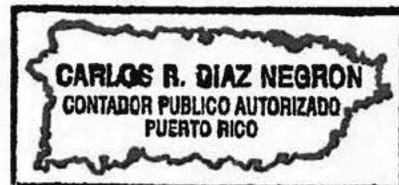
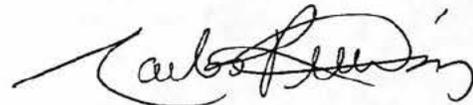
The management of Municipality of Lajas, Puerto Rico is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing my audit, I considered the Municipality of Lajas, Puerto Rico's internal control over compliance with requirement that could have a direct and material effect on a major federal program in order to determine my auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

My consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. I noted no matters involving the internal control over compliance and its operation that I consider to be material weaknesses.

This report is intended solely for the information and use of the management and the Municipal Legislative Body of the Municipality of Lajas, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

December 15, 2006
Aguas Buenas, Puerto Rico

License No. 1339
Expire December 1, 2007



The stamp No. 2204052 of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2006

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Schedule Of Findings And Questioned Costs
For The Year Ended June 30, 2006**

SECTION I. - SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued

Unqualified

Internal control over financial reporting:

- Material weakness(s) identified? ___yes X no
- Reportable condition(s) identified
that are not considered to be material weaknesses? ___yes X no

Noncompliance material to financial statement noted? ___yes X no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? ___yes X no
- Report condition(s) identified that are not considered
to be material weakness(es) ___yes X no

Type of auditor's report issued on compliance for
major programs

Qualified

Any audit findings disclosed that are required to be
reported in accordance with section 510(a) of
Circular A-1331 ___X yes ___no

Identification of major programs:

CFA Number(s)

Name of Federal Program

14.228

Community Development Block

Dollar threshold used to distinguish between type A
And type B programs:

\$300,000

Audit qualified as low-risk audited?

___X yes ___no

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Schedule Of Findings And Questioned Costs (Continued)
For The Year Ended June 30, 2006

Section II. – FINANCIAL STATEMENTS FINDING

NONE

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Schedule Of Findings And Questioned Costs (Continued)
For The Year Ended June 30, 2006

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (CONTINUED):

Finding No. 01-06 – Special Tests and Provisions

Federal Program

CFDA – 14.228 – Community Development Block Grant/States Program

Compliance requirements:

Special test and provisions - Rehabilitation

Category:

Compliance

Condition:

As part of our audit procedures we tested 10 participants of the rehabilitation program. The exceptions noted were the following:

Incomplete notification of the request determination	8
Incomplete participation contracts	7
Incomplete inspections:	
A. Preliminary	4
B. Intermediate	5
C. Final visit	2
Incomplete valuation visits.	6
Incomplete works agreements.	7
Photos of the residence to be rehabilitated:	
A. Intermediate	6
B. Final	1

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Schedule Of Findings And Questioned Costs (Continued)
For The Year Ended June 30, 2006

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (CONTINUED):

Finding No. 01-06 – Special Tests and Provisions (Continued):

Property's title or other legal documentations	1
No progress report.	8
OCAM Form RV-DR-OS-008 (for final works)	3

Criteria:

The OCAM Office Manual of Disaster Recovery 2005 establishes that the files of the participant which obtain the approved for services should include the following documents:

- A. Complete application signed by the residence's occupants
- B. Income verification
- C. Evidence that the participant live in the house to be rehabilitated
- D. Title of the property or other legal document
- E. Notification of the request determination
- F. Photo of the residence to be rehabilitated
- G. Supporting of the payments done
- H. Estimated rehabilitation costs signed by all parties
- I. Work agreement signed by all parties
- J. Form of materials received signed by the parties
- K. Initial and final visits reports
- L. Final report of the closing of works
- M. Participation agreement (OCAM Form RV-DR-05-006)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS
Schedule Of Findings And Questioned Costs (Continued)
For The Year Ended June 30, 2006

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (CONTINUED):

Finding No. 01-06 – Special Tests and Provisions (Continued):

- N. Photos of the residence in the intermediate process
- O. Inspection form
- P. Progress report
- Q. Expenses register

Effect:

The Municipality could be exposed to administrative action by the grantor.

Questioned cost:

None

Recommendation:

I recommend the Municipality to establish adequate procedures and controls to ascertain that comply with the requirements of the program.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LAJAS**

EXHIBIT I

CORRECTIVE ACTION PLAN

YEAR ENDED JUNE 30, 2006



LAJAS - 1883

ESTADO LIBRE ASOCIADO DE PUERTO RICO
GOBIERNO MUNICIPAL DE LAJAS

Programas Federales

Apartado 910
Lajas, Puerto Rico 00667

Tel. : (787) 899-8181 Fax: (787) 899-8191

Hon. Marcos A. Irizarry Pagán
Alcalde



Marcos A. "Turin" Irizarry
Alcalde

To: Mr. Carlos R. Diaz Negron
Certified Public Accountant

From: Mrs. Marilyn Padilla Hernandez
Federal Program Director

Date: March 8, 2007

Subject: Action Plan Taken For Audit Report 2006

According to the findings submitted to us by single Audit Report 2006, from Mr. Carlos R. Diaz Negron certified Public Accountant: I have given immediate instructions to the personnel that works with Housing Rehabilitation, that all files and families attended with this Program be completed with all the forms and requirements of the manual of "Disaster Recovery Act Program".

This is the immediate action we have taken in Federal Programs for the correction of the findings in the single Audit Report 2006.


Marilyn Padilla Hernandez
Federal Program Director

MPH/bmr